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IN THE

Supreme Court of the United States

October Term, 1955

No. 584

FRANK GENTLES, *et al.*,

Appellants,

—against—

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, *et al.*,

Appellees.

BRIEF IN OPPOSITION TO APPELLEES' MOTIONS TO DISMISS

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FRANK GENTLES, *et al.*, *Appellants*, —*against*— F. BRITTON MCCONNELL, as Insurance Commissioner of the State of California, *et al.*, *Appellees.*	No. 584

BRIEF IN OPPOSITION TO APPELLEES' MOTIONS TO DISMISS

POINT I.

The order of the Insurance Commissioner of California was a taking of Appellants' property contrary to the 14th Amendment.

Appellees' attack upon both our grounds for appeal—and upon our position on those issues which, apart from the grounds for appeal, are reviewable by this Court on *certiorari*—rests in large measure upon the proposition that the order (or, as they prefer to call it, the "action") of the Insurance Commissioner did not effect a "taking" of Appellants' property, but only authorized private persons to carry out a transfer of property upon which they had previously agreed (NC.* 13, 17-19; Comm. 21-25); and that, therefore, no substantial federal question is raised on this appeal.

*"NC." refers to the motion of the New Company; "Comm." to that of the Commissioner.

The "agreement", by which Appellants are said to be bound, is the Rehabilitation Agreement of 1936; and its binding effect is said to result from the order of the Superior Court approving it in 1936, which is said to be *res judicata.*

The provision of the Rehabilitation Agreement that is determinative, according to the Appellees, is the Conservator's agreement that he, as sole stockholder of the New Company, would consent to any mutualization plan that might be devised by the PDC. According to the argument, the moment that agreement was made there occurred whatever taking of Appellants' property has occurred; the rights of Appellants as beneficial owners of the New Company's stock then ceased and, from that time on, their sole interest in the rehabilitation of their Company consisted of the right to receive whatever purchase price the PDC might fix for the stock of the New Company, less any part thereof that might be needed to pay creditors.

If the "taking" of Appellants' property in 1936 was an unconstitutional deprivation of property without due process of law, Appellees say we cannot complain of it now, since "constitutional issues, equally with other issues, can be foreclosed by *res judicata*" (NC. 17); and therefore, the argument runs, there was no issue of "taking" in the present case, and the courts below correctly held that the order or action of the Insurance Commissioner was a mere license, not subject to independent judicial review.

Whether in this case there has been a "taking" of property, in the sense of the 14th Amendment, is a matter that this Court will determine by an independent examination of the substance and effect of the State action. *Macallen Co.* v. *Massachusetts,* 279 U. S. 620, 625-26; *International Steel Co.* v. *Surety Co.,* 297 U. S. 657; *Scott* v. *McNeal,*

154 U. S. 34, 45. The California courts cannot nullify Appellants' federal claim by labeling the Commissioner's order as a license. *Cf. Hansberry* v. *Lee,* 311 U. S. 32; and see *Angel* v. *Bullington,* 330 U. S. 183, 190-91.

Appellees make a number of references to "consent" of stockholders. They seem to imply, without quite formulating the proposition, that—in addition to the consent of the Conservator to the Mutualization Plan—in some way the stockholders of the Old Company affirmatively consented to the terms of the Rehabilitation Agreement, and therefore are bound by it as a matter of contract. The Commissioner (Comm. 23) asserts the proposition that the stockholders "were afforded ample opportunity to be heard in 1936 on the question as to whether" the Conservator should enter into the Rehabilitation Agreement; but he goes on to support that proposition by quoting a statement of the District Court of Appeal which goes much further than the Commissioner's proposition (App. B-35):

> ". . . Petitioners were parties to the proceeding in which the rehabilitation agreement was proposed, and their representatives participated in seeking that approval. They may not now complain of its terms."

No citation to the record is given to support the quoted statement, and none could be adduced.* There is no evidence

*Appellees quote the District Court of Appeal for a number of statements that are inaccurate and even contrary to fact; but, as in the above instance, the particular quotation from the Court of Appeal goes much further than the proposition for which the Appellees cite it. That method of argumentation is likely to leave an erroneous impression. We note, therefore, that the decision and opinion of the Court of Appeal were vacated by the grant of a hearing by the Supreme Court; that under California law they are a nullity; and that, therefore, quotations from the Court of Appeal's opinion do not prove anything. *Estate of Scott,* 90 Cal. App. 2d 21, 24; *Estate of Kent,* 6 Cal. 2d 154, 156.

that the Old Company stockholders gave their consents to the Rehabilitation Agreement. They were not asked to consent; for neither the Rehabilitation Agreement nor the order of the Superior Court approving it rested, or purported to rest, upon the consent of anybody.* The transfer of the Old Company's assets to the New Company, the provision for future mutualization which would turn over Appellants' equitable interest in the rehabilitated enterprise to the policyholders, and all the other provisions of the Rehabilitation Agreement, were parts of a plan devised by the Insurance Commissioner for reorganizing a temporarily insolvent company which he had seized.

The Rehabilitation Agreement was a plan of reorganization formulated by a statutory trustee and judicially enforced by embodiment in an order of the Superior Court. Insofar as it bound policyholders, creditors and stockholders, it did so because the State, through the Commissioner and the Superior Court, exercised its soverign power to seize the Old Company's assets and lay down the conditions upon which they would be turned over to the New Company.

The taking of Appellants' property in this case was accomplished by a series of steps, which in their cumulative effect have produced the result that we claim is unconstitutional: (1) The stock of the New Company was made subject to an "option to mutualize"; and the Commissioner, as Conservator, agreed to leave the determination of price to a committee, and to accept such price and terms as the committee should fix; (2) the PDC fixed a price and terms which, as we have attempted to show in our Jurisdictional

*The order of the Superior Court approving the Rehabilitation Agreement did not rest on the consent of the policyholders, creditors or stockholders, but upon notice given to them and an opportunity to them to appear and be heard at the hearings on the Rehabilitation Plan (Ex. 8, cited in Op. Br., App. II, pp. 1-7).

Statement, were manifestly confiscatory; (3) the Commissioner approved the terms as fair and equitable, in an ostensible exercise of his judgment, while the same Commissioner, acting in his capacity as Conservator, consented to the plan—purporting to give the stockholders' consent required by § 11526(b)—but without determining *or even considering* whether it was in the best interests of the stockholders and creditors for whom he was trustee; and (4) the California courts denied independent judicial review of the price and terms, holding that the Commissioner had no more than a licensing function under § 11527. The courts contented themselves with a finding that there was substantial evidence before the PDC and the Commissioner, and that they had not acted arbitrarily; and so they thus failed to grapple with any of the questions of confiscation that were created by the Mutualization Plan.

Whatever may be said of any one step in the proceedings, the result of the totality of State action is that Appellants' equitable interest in the New Company's stock has been taken from them

(1) against their will;

(2) without any action on the part of the Conservator, as statutory trustee for the Old Company and its creditors and stockholders, to get the best price—or even a fair price—for their only asset;

(3) without any truly disinterested or independent determination of the fairness of the Plan by the Commissioner himself; and

(4) without a constitutionally adequate judicial review of the administrative finding that the Plan was fair and protected all interests.

It seems to us that there can be no escape from the conclusion that the sum total of State action, as described, violates the due process clause of the 14th Amendment, under all the authorities, from which there is no exception that we have found or Appellees have cited. The cases by which we support that conclusion are cited in the argument which follows.

The only escape from that conclusion is the one which Appellees rely on—that we are foreclosed by *res judicata* or—what amounts to the same thing—by the failure of stockholders in the 1936 proceedings to object to those provisions of the Rehabilitation Agreement of which we now complain, or to appeal from the order approving it.

There is nothing in the record to indicate that, in the hearings before the Superior Court in 1936, any stockholder did object to the provision for advance consent of the Conservator to a plan of mutualization; and it appears from the *Neblett* case* that no stockholder appealed from the order approving the Rehabilitation Plan. Thus the matter was not litigated in 1936; and the issue of whether the Old Company stockholders are now foreclosed, by *res judicata* or estoppel, from attacking on constitutional grounds the validity of the provision for advance consent of the Conservator, depends on two questions:

(1) Did the Superior Court in 1936 necessarily decide the point *sub silentio;* in other words, did the order approving the Rehabilitation Agreement necessarily approve the provision for the Conservator's advance consent?

(2) If so, could the stockholders have appealed from that approval, on constitutional grounds, in 1936?

**Carpenter* v. *Pacific Mut. L. Ins. Co.*, 10 Cal. 2d 307, *aff'd sub nom. Neblett* v. *Carpenter*, 305 U. S. 297.

Upon the plainest principles, the answer to both questions is No, and the Old Company stockholders are not foreclosed by *res judicata* or estoppel from attacking the mutualization provisions on constitutional grounds, as they did in the courts below.

The Superior Court in 1936 did not pass upon the provision of the Rehabilitation Agreement for advance consent of the Conservator to a plan of mutualization.

The Rehabilitation Agreement was carefully drawn to make it unnecessary for the Superior Court to pass upon the Conservator's agreement to consent, sight unseen, to any mutualization plan that might come out of the hopper, or his other agreements by which he curtailed his power to deal with the stock of the New Company in the best interests of his beneficiaries.* It was expressly provided, with respect to the mutualization provisions (but not with respect to any other provisions) of the Rehabilitation Agreement, that (App. F-31):

> "(f) If the provisions of this paragraph 20, or of any one or more of the subparagraphs hereof, should be contrary to law or illegal or void, *then such paragraph, subparagraph, or subparagraphs, shall be null and void,* and shall be deemed separable from the remaining covenants and agreements in this agreement contained; and shall in no way affect the validity of any of the remaining provisions of this agreement." (Emphasis ours)

It was further provided in paragraph (25) of the Rehabilitation Agreement (App. F-34) that:

E.g., paragraph (20), subparagraphs (b) and (c) (App. F-28-30).

> "(25) . . . All undertakings and obligations herein set forth as undertakings or obligations of the Conservator are made only in his said capacities *and to such extent as he had authority to make the same,* and the Conservator makes no warranty of his authority to make the same." (Emphasis ours).

Thus the parties to the Rehabilitation Agreement—the Insurance Commissioner as Conservator and the New Company—avoided having to ask the Superior Court in 1936 to approve either the mutualization provisions or any other future commitment of the Conservator. Had anyone challenged the legality of the advance consent on the ground that it was beyond the Conservator's authority, or was a breach of his statutory trust duties toward the Old Company stockholders, the objection would have been met by the conclusive argument that, if it was well taken, the provision would be null and void and the objector could suffer no harm; that the Court had not approved it, except insofar as it should be found to be a lawful exercise of the Conservator's power; and that, if there should ever be a plan to which the consent became applicable, then would be time enough to decide the issue of its validity. The pertinent authorities are cited below.

There could be no purpose in putting paragraph (20)(f) and paragraph (25) into the Rehabilitation Agreement except to insure that the validity of the mutualization provisions would not have to be litigated in 1936—or, to put the point in another way—except to insure that the order approving the Rehabilitation Agreement would not foreclose the issues to which the exceptions and reservations applied. Those provisions removed from the field of justiciable controversy in 1936 the agreement of the Conserva-

tor to delegate the determination of price to the PDC and to consent to any plan of mutualization it might devise.*

By ignoring the effect of the reservations in the Rehabilitation Agreement, and holding that the provision for advance consent was approved by the Superior Court in 1936 and was *res judicata,* the courts below have made the Rehabilitation Agreement a trap for the unwary. The stockholders were entitled to take the reservations and exceptions as meaning what they said. *Conn. Gen. L. Ins. Co.* v. *Johnson,* 303 U. S. 77, 79-80. Now, having been lulled into security by the reservations and exceptions, they find them written out of the Agreement by the California courts—with the result that the stockholders have not had their day in court to assert constitutional rights. *Cf. Hansberry* v. *Lee, supra,* p. 3.

There was another provision of the Rehabilitation Agreement that was calculated to make the issue of advance consent a non-justiciable issue in 1936, and also has proved a trap for the unwary. The Agreement provided that any mutualization plan would have to conform to the voluntary mutualization statute; and the statute at that time and ever since has required, as a condition to mutualization, that the Commissioner has to approve the plan after first satisfying himself that "the rights and interests of the insurer, its policyholders and shareholders are protected," and "that the plan will be fair and equitable in its operation." (§ 11527, App. E-11-12).

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*Another reason why the propriety or legality of the Conservator's advance consent could not present a justiciable controversy in 1936 is that the Mutualization Plan was to be formulated "in accordance with the laws of the State of California in effect at the time" when the request for mutualization might be made, *i.e.,* between July 1, 1946, and January 1, 1948; and no one could know in 1936 what the statute might provide 10 years later.

If any stockholder in 1936 had been able to imagine a situation in which the advance consent of the Conservator would be held to reduce the Commissioner's duty under § 11527 to the ministerial level for which Appellees now argue,* and had raised the question of due process under the 14th Amendment, he would of course have been told that it must be presumed (a) that the Commissioner would act lawfully when the time came; (b) that the measure of judicial review of the Commissioner's findings would conform to constitutional requirements; and (c) that whatever the laws of California, as in force 10 years later, might require to be done would be done. *Cf. Electric Bond & Share Co.* v. *SEC*, 303 U. S. 419, 443; *Anniston Mfg. Co.* v. *Davis*, 301 U. S. 337, 354-55; *National Fertilizer Asso.* v. *Bradley*, 301 U. S. 178; *Corporation Comm.* v. *Lowe*, 281 U. S. 431, 438.

The sum and substance of the matter, as we see it, is that the Rehabilitation Agreement was framed to make it unnecessary—and in fact legally impossible**—for the issue of advance consent of the Conservator to be litigated in 1936; and it was not litigated, *and could not have been litigated;* but that the courts below, in violation of due process requirements, have held the Appellants to be bound by that provision nevertheless.

If, as we contend, the advance consent of the Conservator is part of the totality of State action which has

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*All the Commissioner had to do, according to Appellees (NC. 14), was to say: "I find nothing wrong with the plan from any official standpoint; the Company may, therefore, proceed with the remaining steps to voluntary mutualization."

**There is no more settled principle in the law of *res judicata* than that the doctrine cannot apply to situations where the events needed to make a controversy justiciable had not yet occurred at the time of the former judgment. *Lawlor* v. *National Screen Service*, 349 U. S. 322, 328; *Auto Acetylene Light Co.* v. *Prest-O-Lite Co.*, 264 Fed. 810, 815, *cert. den.* 258 U. S. 622.

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resulted in a deprivation of property without due process of law, it avails Appellees nothing to argue that *res judicata* is a matter of State law. Even if it were, this Court would examine the basis for application of *res judicata,* in order to determine whether it had resulted in a violation of federal constitutional rights; for this Court will not permit a State court, by calling something *"res judicata"*, to evade a constitutional issue upon a colorable or unsubstantial ground. See *Memphis Gas Co.* v. *Beeler,* 315 U. S. 649, 654; *Ward* v. *Love County,* 253 U. S. 17, 22; *Williams* v. *Kaiser,* 323 U. S. 471, 478.

But the issue is not an issue of State law. It presents purely a federal question, *viz.,* whether an objection to the Conservator's advance consent, as a violation of the due process clause of the 14th Amendment, could have been litigated in 1936; and that depends upon whether, upon appeal or certiorari, the issue would have been a proper one for this Court to decide. What the State courts did, or could or would have done if the question had been presented to them in 1936, is beside the point. If one of the petitioners in the *Neblett* case had been a stockholder of the Old Company, and he had asked this Court to rule that the provision of the Rehabilitation Agreement calling for the advance consent of the Conservator was a deprivation of Appellants' property without due process of law, can there be any doubt about what this Court would have held?

Upon the most familiar principles governing this Court's exercise of its power to decide constitutional questions, it would have held that the stockholder's attack upon that provision of the Rehabilitation Agreement was premature. *Asbury Hospital* v. *Cass County,* 326 U. S. 207, 213-15.* There might never be a Plan, hence never a consent; and in

*See also cases cited in second footnote on page 10.

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view of the Conservator's reservation, there might be a plan *but no consent,* because the Conservator, if advised that the advance consent was invalid, might withdraw it. An invalid consent could not have consequences until there was a mutualization plan; and it might not have any consequences even then.

The cases which Appellees cite in support of their application of *res judicata* are irrelevant to the issue. In two of them, *res judicata* (or estoppel) was applied against a party because in a prior proceeding he had had an opportunity to carry his constitutional objection to this Court and had failed to do so*. In all the others (NC. 16-17), the question was whether a prior decision was binding although erroneous or subject to a jurisdictional defect. There is no such question here. We are not attacking the 1936 order of the Superior Court. We are only pointing out what it did not decide.

Even if the advance consent were valid, it would not preclude a constitutional attack on the totality of State action for still another reason, *viz.*, that it was a *qualified* consent. As we have pointed out, it was a consent only to a plan which the Insurance Commissioner should find adequate to protect the interests of the stockholders and others interested, and which would be fair and equitable in its operation. The courts below, however, have written the condition out of the Rehabilitation Agreement. How they have managed to do that may be seen from Appellees' motions, wherein they persistently treat the Conservator as if he were the stockholder of the New Company in his own right. For example, the Commissioner says (Comm. 22):

> "The stockholder (*i. e.*, the Liquidator, in whose right Appellants sue) is manifestly not unconstitu-

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Angel v. *Bullington, supra; Grubb* v. *Public Utility Commission,* 281 U. S. 470.

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> tionally deprived of property when his property may be taken only as he voluntarily chooses to dispose of it by contract."

and throughout the motions there are other references to "stockholder" in the singular. That exercise in semantics goes back to the very beginning of the case. It appears in the decision of the Insurance Commissioner of September 22, 1950, wherein he worded his ultimate finding thus (App. D-22):

> "IT IS HEREBY FOUND AS A FACT that the rights and interests of the New Company, its policyholders, and the holder of its shares are protected under the terms of the plan hereinabove referred to, and that the plan will be fair and equitable in its operation."

The Commissioner's use of the singular, "holder of its shares," is evidence of a point of view toward Old Company stockholders—one that had been revealed in the Rehabilitation Agreement in 1936. That is probably the only reorganization plan in history that does not contain *a single reference* to the rights or interests of stockholders. The writers of that document achieved the remarkable feat of mentioning stockholders only once—in subparagraph (20)(c) (App. F-29-30) wherein it is provided that, even if the Old Company "or its shareholders" should put up the money necessary to restore non-can liabilities, discharge all the debts and lift the receivership, they still could not get back control of their rehabilitated enterprise.

The exclusion of the interests of the equitable owners of the New Company's stock from consideration is the very essence of the deprivation of property without due process in this case. No attention has been paid to the statutory

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duties of the Liquidator, as laid down in Chapter 1 of the California Insurance Code dealing with "Insolvency and Delinquency":

> "*1057. Commissioner deemed trustee.* In all proceedings under this article, the commissioner shall be deemed to be a trustee for the benefit of all creditors and other persons interested in the estate of the person against whom the proceedings are pending."

Whatever the California Supreme Court *said* in its opinion, what it *did* by its decision was to uphold the Conservator in a breach of his trust duties under the statute.* It sanctioned the Commissioner's action in consenting to the Plan, solely because his predecessor had agreed to give consent and thus had abdicated his trust *in limine*. Had the Commissioner as Conservator paid attention to his trust duties, he not only would have examined and studied the Mutualization Plan for its fairness to Old Company stockholders, but the separate counsel by whom he was represented, in his capacity as Conservator, would have appeared at the hearing on the fairness of the Plan to assert the rights and safeguard the interests of those for whom their client was trustee. Unlike the Old Company and its stockholders, the Conservator had full access to the books and records of the New Company, which was his creature; and at the hearing he could have subjected the Mutualization Plan to critical examination, in the light of all the available facts. Instead, the Conservator's counsel failed even to enter

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*The Commissioner as Conservator and as Liquidator of the Old Company, a position which he still occupies, has been and is trustee with the duty "to conserve and protect" the interests of those who are properly entitled to share in the assets of the trust estate. *Garris v. Mitchell*, 7 Cal. App. 2d 430. Cf. Scott, Trusts, §§ 171, 172 at p. 916 (1939).

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an appearance at the hearing. Compare that lack of interest with the positive roles that counsel for the New York Superintendent of Insurance, as Liquidator, have played in comparable cases in that State.*

Both the California Supreme Court and the Appellees, in dealing with the Conservator's consent to the Plan, have reasoned in a circle. The consent given by the Conservator, because of his predecessor's 1936 contract and without reference to his duty as statutory trustee, is validated by the fact that the Commissioner has found the Plan to be fair. There is thus no *improper* taking of Appellants' property. At the same time, the Commissioner's limited review of the Plan is held to be sufficient because, the Conservator having consented, the Commissioner's duties were only those of one who is called upon to license a voluntary arrangement proposed by private parties, and were not the duties of one who must pass on a "taking" of property. Thus there was no "taking" of Appellants' property *at all;* and thus the approval by the Commissioner validates the consent of the Conservator, and the consent of the Conservator validates the approval by the Commissioner.

But the inescapable fact is that the property of Appellants has been "taken" without their consent, and without an opportunity for the judicial review appropriate when issues of confiscation are involved.

Here the real parties in interest neither agreed to a price nor waived their right to an equitable price and fair terms. The price and terms have not been approved by them, and have not been fixed in fair bargaining by their trustee. They have been fixed by a Committee of third parties having no duty toward the stockholders, and whose

*E.g., *Matter of New York Title & Mortgage Co.*, 171 Misc. 489; *Matter of Globe and Rutgers Fire Ins. Co.*, 149 Misc. 18.

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interests were, if anything, adverse to those of stockholders. They have been approved by the Conservator, not on the merits, but because his predecessor in 1936 agreed to buy his *cestuis* a pig in a poke.

It is idle for the Appellees to say that the Commissioner's approval did not effect a "taking" of property because it was only one step "in a series of approvals which *allows* the company to purchase its own stock" (NC. 13)*. For the effect of the order of the Commissioner as a State officer was to *sanction* the taking of Appellants' interest in the New Company for the benefit of its policyholders. It was the Commissioner's "approval" of the Plan that made effective his advance consent as Conservator, and authorized the Conservator to dispose of the property of which Appellants are the equitable owners. But for the affirmative action of the Commissioner, Appellants' property could be transferred to the New Company only with their consent. The Commissioner's action, therefore, effected a taking by the State itself. *Cf. Shelley v. Kraemer*, 334 U. S. 1, 14, 19; *Eubank v. Richmond*, 226 U. S. 137.

Appellees make two further arguments designed to support their contention that there has been no "taking" of the property of the Old Company's stockholders:

> (1) That, because the Old Company was insolvent in 1936, the stockholders' equity had been wiped out; that if the absolute priority rule of *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, had been applied, the stockholders' interest would not have been permitted to participate in a reorganization; and that, therefore, such rights as the Old Company stockholders now have were *created* by the Rehabilitation Agreement (NC. 16, 18).

*Emphasis ours.

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(2) That the mutualization provisions of the Rehabilitation Agreement are a contract for the benefit of the participating policyholders, who bought the "option to mutualize" by relinquishing their right or claim to $4,792,118.97 of assets which, on the books of the Old Company, had been credited to the Participating Division of its Life Department, but were not transferred to the participating department of the New Company—$3,000,000 having been used to provide the capital of the New Company ($1,000,000) and to give it a paid-in surplus of $2,000,000, and $1,792,118.97 having been turned over to the New Company's Accident & Health Department to provide a cushion for non-can liabilities assumed by it (NC. 5-6; Comm. 9).

Both these arguments have become, by constant reiteration alone, a part of the folklore of the case. Neither has a sound legal foundation, neither accords with the facts, and neither leads to a conclusion that supports Appellees' argument that there has not been a "taking". However, it does not seem advisable to lengthen this brief by discussing either point at length. A brief comment with respect to each of them may suffice:

There has never been any true insolvency in this case (J. S. No. 584, p. 6, fn.). Indeed, the prosperous financial history of the New Company after rehabilitation is a fine justification, in the insurance company field, of the judicial view, often expressed, that reorganization and rehabilitation proceedings are designed to, and frequently do, preserve investment values and avoid premature deflation and the destruction of equities because of conditions which are temporary.*

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*Otis & Co. v. S. E. C., 323 U. S. 624; *In re Equitable Office Bldg. Corp.*, 96 L. Ed. 1386 (Aug. 6, 1946, not officially reported);

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The participating policyholders of the Old Company did not contribute one nickel of surplus to the New Company, because they had no surplus to contribute. The surplus had been wiped out, and the restoration of surplus was due, not to any sacrifice by the participating policyholders, but solely to the contribution which the non-can policyholders made, by accepting an indefinite deferment of various proportions of their actual and potential claims. It was the non-can policyholders whose sacrifice permitted the reduction of reserves, and thereby created the corporate surplus which was distributed among the departments of the New Company. That is made clear in Commissioner Caminetti's report to Governor Warren (Ex. 38, pp. 3-4). Instead of contributing $4,792,118.97 to the other departments of the New Company, the participating policyholders contributed nothing, and got back $423,136 of surplus contributed by the non-can policyholders—and got it back free of all claims of creditors and non-can policyholders (App. F-7).

The two points—that the stockholders' rights are derived from the Rehabilitation Agreement, and that the participating policyholders have a contract right to enforce the mutualization provisions of that Agreement—do not lead to any conclusion that helps the Appellees. All they add up to is that the stockholders are bound by the Rehabilitation Agreement. The question remains: Bound to what? What was the bargain that was made in 1936, and to what does it bind the stockholders?

National Surety Corp. v. *Williams*, 110 F. 2d 873, 877; *In re 325 East 72nd St.*, 53 F. Supp. 997; *Thrower* v. *Kistler*, 14 F. Supp. 217, 219; *National Surety Corp.* v. *Nantz*, 262 Ky. 413; *Matter of People (Title & Mortgage Guaranty Co. of Buffalo)*, 264 N. Y. 69; *Matter of National Surety Co.*, 239 App. Div. 490, *aff'd*, 264 N. Y. 473; *Matter of N. Y. Title & Mortgage Co.*, 168 Misc. 60.

We say that it binds them to everything in the Rehabilitation Agreement that was lawful and proper, but does not bind them to a provision by which their statutory trustee agreed to sell out their equity without exercising his own judgment as to its value, and whereby he abdicated the price-fixing function to three private persons—nor can it bind the stockholders to a sale of their equitable interests at a price and upon terms which they claim are confiscatory, until an appropriate judicial determination is had on the issue of confiscation.

POINT II.

The constitutional questions were properly raised in the State courts.

Our grounds of appeal are: (1) that the State statute (Ins. Code, §§ 11525-27), as construed and applied by the courts below, violates the due process clause of the 14th Amendment; and (2) that the order of the Commissioner likewise violates the due process clause, and is a statute for the purpose of appeal under Jud. Code, § 1257(2).

Appellees challenge both grounds. Insofar as that challenge is based upon the proposition that there has been no "taking" of Appellants' property, and therefore no federal question, we have dealt with it under Point I.

Unconstitutionality of the statute as construed and applied

With respect to the first ground of appeal, Appellees say that it was not raised in the court below; that there was not "an explicit and timely insistence" that the statute, as construed and applied, is repugnant to the Federal Constitution. We rest our appeal under this heading, not upon the

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verbal formulation in the State courts of the issue in terms of the invalidity of the State statute, but rather (a) upon the formulation of the underlying issues of construction and application of the statute, which spell out its invalidity as construed and applied, and (b) upon our contention that the California Supreme Court passed upon those issues and thereby construed and applied the statute (§§ 11525-27) to produce the unconstitutional result, of which Appellants had complained throughout the whole course of the proceedings below.*

We urge that the statute has been construed and applied unconstitutionally in the following holdings of the court below: (1) that the Conservator had the right to give the consent of shareholders required by the statute, without reference to the interests of the equitable owners for whom he was statutory trustee; (2) that he could (and did) bind himself to give that consent in advance, sight unseen; (3) that, in spite of his conflicting interests, the Commissioner as Conservator could give that consent and as Commissioner could be a judge in his own cause; (4) that in discharging his duty under § 11527 the Commissioner did not have to exercise his independent judgment on price and terms, but could rely on the judgment of a committee of three private persons, so long as their decision was not "arbitrary"; and (5) that the Commissioner's approval of the Plan under § 11527 was only a license, and therefore not subject to independent judicial review.

While the arguments in the briefs below are mingled with arguments addressed to the numerous State issues, as must almost necessarily be so when the case is complicated and the issues numerous—and while some do not stand out

*See Petition for Mandate, par. XXII, and accompanying Points of Error (2) and (3), Clk. Tr. 22, 28, 29.

as clearly as might be desired—we believe that anyone reading the briefs for Appellants in the several courts would perceive that the attack on the totality of State action related at almost every point to an issue of statutory construction which, if decided adversely to Appellants, was urged by them as a violation of due process under the 14th Amendment.*

A large part of the constitutional argument in the courts below related to whether the voluntary or involuntary mutualization statute was properly applicable. It was contended by Appellants that the involuntary statute should be applied, because it provided for procedures that were essential to due process, including appraisal of the stockholders' interests and full judicial review; and that, if the voluntary statute was properly applicable, it should be construed to require the same measure of review; otherwise an unconstitutional result would be reached. Thus the burden of the whole argument—whether or not expressed *in haec verba*—was that the construction of the statutes which made §§ 11525-27 applicable, and denied judicial review appropriate to confiscation cases, was an unconstitutional construction and application, which resulted in a violation of the 14th Amendment.

In formulating the argument that the totality of State action, including the construction of the statute, added up to a violation of the 14th Amendment, Appellants at pp. 164-65 of their opening brief in the District Court of Appeal,** after pointing out that the 14th Amendment is a limitation on State action of every character—executive,

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*Op. Br. 6-8, 180, 233-243, 288; Pet. H. 10-11; Pet. Reh. 3-4, 25.

**The same brief was filed in the California Supreme Court and was the main presentation of Appellants in that court.

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legislative, judicial and administrative—* put the argument thus:

> "But the different components of state action involved cannot be considered separately for this purpose—it is the totality of state action which determines whether there has been a deprivation of property without due process of law.
>
> "Had either the order of the Court or the order of the Insurance Commissioner by itself approved a specific Plan which required the sale of the stock at a confiscatory price, a typical deprivation of property without due process of law would have occurred. No lesser deprivation by the state occurs because that result is achieved as a consequence of the combined actions of the state court and the state Insurance Commissioner, rather than by either of them acting alone."**

Similarly, the Petition for Hearing in the State Supreme Court (pp. 2-3) stated:

> ". . . the District Court of Appeal deprived Appellants of property without due process of law and denied them the equal protection of the laws, all contrary to the Fourteenth Amendment of the Constitution of the United States and thereby ousted itself of jurisdiction."

The California Supreme Court upheld the statute as not requiring independent judicial review, and as not violat-

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*Citing *Norris* v. *Alabama*, 294 U. S. 587, 589, quoting *Carter* v. *Texas*, 177 U. S. 442, 447; *Shelley* v. *Kraemer*, 334 U. S. 1, 14-15; *Raymond* v. *Chicago Traction Co.*, 207 U. S. 20, 35-36; *West Virginia State Board of Education* v. *Barnette*, 319 U. S. 624, 637; *Hutchinson* v. *Coughlin*, 42 Cal. App. 664, 669.

**Citing and quoting from *Wheeling Steel Corp.* v. *Glander*, 337 U. S. 562; *Cole* v. *Arkansas*, 333 U. S. 196; and *Frank* v. *Mangum*, 237 U. S. 309.

ing constitutional rights because there was no "taking". The Court said (App. A-14):

> ". . . The approval of the mutualization plan by the commissioner did not involve any deprivation of property rights or vested rights; it was in essence a permit or license authorizing the new company to purchase its own stock. Under these circumstances the function of the superior court was to determine whether the action taken by the commissioner was arbitrary or constituted an abuse of discretion, and in upholding the action of the commissioner, it properly refused to conduct a trial de novo."

Justice Carter, dissenting, dealt with both phases of the constitutional issue in the following passage (App. A-62):

> ". . . This [*i. e.,* that the Commissioner's order was a mere license] *would* be true *if* new company members owned their own stock (and therein lies the fallacy in calling new company a solvent corporation with all that term connotes). But the matter is not quite so simple. All the beneficial ownership, which is the *real* ownership is held by the policyholders and stockholders of old company; all the legal title is held by the voting trustees (appointed by the commissioner) for the benefit of *old company* policyholders and stockholders. . . . We held in the Drummey case that we could see no escape from the conclusion that the court must weigh the evidence and exercise its independent judgment on the facts as well as the law, if the complaining party was to be accorded his *constitutional rights* under the state and federal Constitutions. 'The state constitutional provision discussed, *supra,* prohibits the conferring of judicial power on such administrative boards.'" (Emphasis is Justice Carter's.)

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Thus it was Justice Carter's view that the statute, as construed to involve merely a license, the granting of which was not subject to independent judicial review, was unconstitutional; and he went on to discuss the authorities under the 14th Amendment, citing and quoting from *St. Joseph Stock Yards Co.* v. *United States,* 298 U. S. 38, 52, citing *Ohio Valley Water Co.* v. *Ben Avon Borough,* 253 U. S. 287, and pointing out that what he considered to be the governing case under California law—*Drummey* v. *State Board of Funeral Directors,* 13 Cal. 2d 75—had been decided on both state and federal constitutional grounds.

We submit that the issue of whether the statute, as construed and applied, is constitutional was raised below with sufficient clarity to be decided, and that it was decided by the California Supreme Court. If that be so, then this Court will not concern itself with how artistically the issues were formulated, but will presume conclusively that the questions were properly raised. See *Charleston Federal Savings & Loan Assn.* v. *Alderson,* 324 U. S. 182, 185-86; *Manhattan Life Ins. Co.* v. *Cohen,* 234 U. S. 123, 134.

If we are not right on that, then we submit that the issues which pertain to our first ground of appeal should be considered as a basis for the grant of a writ of certiorari.

The Commissioner's order as a State statute

With respect to our second ground of appeal—that the order of the Insurance Commissioner approving the Plan of Mutualization was an unconstitutional "statute" within the meaning of Jud. Code, § 1257(2)— Appellees argue that the Commissioner's order was not a "statute", because it did not order anyone to do anything, did not have any

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general or continuing force, was not intended to have application in the future, and did no more than authorize the New Company to take the remaining steps toward mutualization; and further, it is said, we did not urge in the court below that the Commissioner's order was a "statute".

The question of whether the order of the Commissioner was a statute for the purpose of 28 U. S. C. § 1257(2) is one that arises first in this Court, and the fact that "the State court was not told it was being asked to determine the constitutionality" of the order as a "statute of the state"—"that such matter was not 'drawn in question' " (Comm. 20)—is irrelevant. The validity of the Commissioner's order (or "action") was drawn in question on every ground now relied upon in this Court*; and the only issue that now arises here is whether, as we contend, that order is to be treated as a statute under this Court's decisions interpreting that word in § 1257(2) of the Judicial Code. *Atchison R. R.* v. *Pub. Util. Comm.*, 346 U. S. 346, 348. No question involving the construction of § 1257(2) was before the courts below.

Whether the Commissioner's action was legislative in character is a question for this Court to decide; and it cannot turn on the categories employed by the State courts, or how the State court treated the action in the particular case, or how we characterized the Commissioner's functions before the State courts. We characterized the Commissioner's action as judicial or quasi-judicial, within the meaning of the California statutes governing the right of review of orders of officials; but that does not make the Commissioner's determination any less legislative in character for the purposes of § 1257(2).

*J. S. No. 584, pp. 17-21.

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This Court has repeatedly recognized that orders of officials or administrative bodies regulating rates and other activities of businesses involve the exercise of both the judicial function and power which is legislative (or "quasi-legislative") in character. *Morgan* v. *United States,* 298 U. S. 468, 479-80; *Southern Railway Co.* v. *Virginia,* 290 U. S. 190, 197. Yet this Court has consistently treated the orders of such agencies as "statutes" for the purpose of appeal. *Sultan Ry. Co.* v. *Dept. of Labor,* 277 U. S. 135; *Northern Pacific R. R.* v. *Dept. of Pub. Works,* 268 U. S. 39; and compare Section 2(c) of the Administrative Procedure Act (5 U. S. C. § 1002(c)) which explicitly defines "rule making" (as distinguished from "adjudication") to include corporate reorganization matters.

The Insurance Commissioner made his order approving the Plan of Mutualization pursuant to a power delegated to him by the California legislature, to be exercised according to the standards laid down in § 11527 of the Insurance Code. When the Commissioner was called upon to apply those legislative standards to the particular plan submitted to him in this case, he was acting as an arm of the legislature. See cases cited in footnote, p. 27.

This Court has consistently regarded orders of that type as "statutes" from which appeals may be taken under 28 U. S. C. § 1257(2) and its predecessor statutes. In *Lake Erie & W. R. R.* v. *Pub. Util. Comm.,* 249 U. S. 422, this Court held that an order requiring a single railroad to build a single side track was a "statute"; and, in other cases this Court upon the same ground has entertained appeals from orders of State administrative agencies setting rates for one particular utility or corporation under a broad legislative standard of reasonableness. *Live Oak Assn.* v. *R. R. Commission,* 269 U. S. 354; *Market Street*

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R. Co. v. *Railroad Commission of California,* 324 U. S. 548.

In *Atchison R. R.* v. *Pub. Util. Comm., supra,* it was held that an order of the California Public Utilities Commission authorizing a plan of the City of Los Angeles for enlarging two railroad underpasses, and determining the division of costs between the railroad and the city, was a "statute" within the meaning of Section 1257(2). The order of the Insurance Commissioner here was no less an exercise of delegated legislative power than that of the Commission in the *Atchison* case.

The New Company cites six cases in support of the proposition that the Commissioner's action was not a "statute of a state" within Jud. Code 1257(2). In only one of the cases (*Standard Scale Co.* v. *Farrell,* 249 U. S. 571) was an opinion written; and that case merely holds that a particular action of the State Superintendent of Weights and Measures was purely "educational, and at most, advisory" (at p. 574). The other cases were memorandum decisions and are completely inconclusive, in view of the clear authority that is to be found on the subject in reported opinions.

Appellees dismiss with a wave of the hand the State court cases that we cited to show that mutualization has invariably been held to be a legislative function.* But those cases are very much in point. The three New Jersey cases show that the Chancellor, when given power to administer proceedings for mutualization of insurance companies, to appoint appraisers to fix the price, or permit the price to be fixed by agreement of all concerned, was held to be a

Lord v. *Equitable Life Assurance Society,* 194 N. Y. 212; *Belden* v. *Union Central Life Insurance Co.,* 143 Ohio St. 329; *In re Prudential Insurance Company,* 82 N. J. Eq. 335; *Rippel* v. *Prudential Insurance Company,* 85 N. J. L. 395; *Application of Prudential Insurance Company,* 132 N. J. Eq. 170.

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"legislative agent", whose actions could be reviewed only by the prerogative writ of certiorari; and in that connection it may be worthy of note that the constitutionality of the statute was upheld, against attack under the due process clause of the 14th Amendment, upon the ground that the price arrived at, by whatever method, was "subject to inquisition and approval by the Chancellor"—in short, that there was a right to judicial review. See *Application of Prudential Insurance Co.*, 132 N. J. Eq. 170, 176.

Appellees argue (NC. 14) that the *Belden* case (cited in preceding footnote (p. 27)), which they say is the only case "remotely similar to the present one", held that the Ohio mutualization statute "does not delegate legislative power." But the *Belden* case merely applied the familiar principle that, while legislative bodies may not delegate their powers, they may legislate in terms of general principles, enact standards, and assign to an official or an administrative body the duty of applying those standards in particular cases. The powers of the Ohio Commissioner, under the mutualization statute of that State, are similar to those of the California Commissioner under the California statute; and so it is of interest that the Ohio court called those powers "quasi-legislative and quasi-judicial" (143 Ohio St. at 342-43). That is the description that precisely fits the rate cases and the other cases (*supra*, and J. S. No. 584, p. 3), where this Court has held State official action to be a "statute of a state", under Jud. Code § 1257(2).

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POINT III.

Appellees have not overcome any of the objections that we have made to the PDC's determination of price and terms of mutualization.*

Our attacks on the methods and conclusions of the PDC raise two different types of questions—those pertaining to *value* and those pertaining to *price*. They are not the same; for we could concede that $3,000,000 was a fair valuation of the New Company's capital stock at December 31, 1948, without conceding a single one of our objections to the price and terms of payment fixed by the PDC. If the $3,000,000 price had been payable within a reasonable time after the PDC's decision, as a fixed obligation and with a reasonable rate of interest, a very different case would be presented. But disregarding the contingent character of the obligation to buy the stock, the remoteness of the time of payment, the absence of current interest, the non-compensatory rate of interest and all the other

*There is an error in our Jurisdictional Statement, to which both Appellees have called attention, and we want to correct it. The second and third paragraphs of the material on pp. 14-15 under the heading "7. Provisions for payment of the purchase price" was originally written to make the point that, because under the formula that governed the surplus that the New Company must have, before it can become obligated to buy its stock, it may be a long time before that obligation will become firm, however soon the non-cans may be paid off. Our figures on page 15 were intended only to show how large a surplus the Company would have to have before the condition respecting surplus would be met. However, the third paragraph was actually phrased to present a contrast between the total required surplus and the $3,000,000 price.

That, as Appellees point out (NC. 27, footnote; Comm. 29, footnote), is not a fair comparison, because any total surplus figure for the Company will include surplus of the Participating Life Department, in which the stockholders do not have the beneficial interest. Hence we request that the last sentence be considered as withdrawn and stricken.

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objections to the Mutualization Plan, it is a basic fact that it does not even provide for a payment having a value of $3,000,000 as of December 1948.*

Arguments pertaining to value

The arguments of Appellees on the matter of value are:

(1) That the PDC were experts, that they made a careful study of the earning power of the New Company, and therefore their figures can be relied on.

(2) That no countervailing evidence of value was put in by the opponents of the Mutualization Plan.

(3) That PDC members testified that, if they had valued the stock on either of two other bases, the value would have been less and there might not have been any value. The two bases suggested were:

(a) So many times current earnings in 1948, taking as the standard the times-earnings basis on which other life insurance stocks were then selling. (This, it is said, would have yielded no value, after

*The Superior Court caught that point, and in its opinion said (App. C-33-34):

"PDC might well have approached the problems presented to it and resolved those problems differently than they did. We may not agree with their approach or with their reasoning, but we cannot say, nor could the Commissioner say, that they acted without reason, and neither the Commissioner nor this Court can substitute his or its reasoning for that of the committee.

"I have arrived at this last conclusion reluctantly because of the fact that all the shareholder presently receives under the plan is a conditional promise to pay a sum of money at a distant date in the future and this promise has a *present value*, if the sum to be paid is discounted, for interest only, at 3%, *much less* than the sum which the committee finds to be the present value of the stock." (Emphasis ours.)

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making allowance for the non-can liabilities as the PDC estimated them.)

(b) So many dollars per $1,000 of insurance in force, that being said to be a rule of thumb sometimes used in buying and selling insurance companies. (That basis, it is said, would have yielded either no value or only a small value—depending upon the number of dollars per $1,000 used as the multiplying figure—again after deducting the estimated non-can liabilities.)

We comment briefly on Appellees' points:

(1) Experts, as every appellate court knows, are sometimes the most unreliable readers of the future (see *Bondholders, Inc. v. Powell,* 342 U. S. 921, 925-26*); and the reason is not hard to find. They must estimate all future factors on the most conservative basis, and the underesti-

*The following remarks of Mr. Justice Frankfurter, dissenting from the denial of certiorari in the *Powell* case, are fully applicable, *mutatis mutandis,* to the present case:

"For what the Seaboard situation proves is not the mischance of a mere guess. It calls into question the whole process of dealing with this problem. The estimates that have been so vastly negatived by the event were the product of four years of intensive study by a Special Master, qualified as a specialist in railroad affairs, with special knowledge of the Seaboard, estimates confirmed by a vast judicial apparatus. And the Seaboard is not an isolated case. In other railroad cases post-prediction earnings over a substantial period are far above the estimates on which extinction was decreed against junior securities. Indeed, the records of these railroad reorganizations at the hands of the Interstate Commerce Commission and special masters and courts have inevitably aroused deep skepticism as to expertise in this field, or, at least, as to reliance in decreeing drastic forfeitures on the basis of it. It is not to be wondered that both the Executive and the Congress have recorded dissatisfaction with the heavy incidence of forfeiture decreed by courts, not by virtue of specific authorization but as a matter of judicial administration."

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mates of factor after factor in the problem are compounded in a geometric proportion. The expertise of the PDC might be more convincing if it had survived a critical examination by the Conservator and his counsel, acting in the interests of those for whom he was a statutory trustee.

(2) The attorney for the Stockholders' Committee did not put in evidence on valuation before the Commissioner, but confined himself to cross examination and argument. That fact, however, does not make the PDC's methods of arriving at *price* any better; and it is our contention that those methods are unsound and unconstitutional *on their face.*

As a matter of fact the Commissioner did have before him evidence of value that was far more tangible, solid and convincing than the actuarial speculations of the PDC. It was an offer by American National Insurance Company, a responsible corporation, 82% controlled by one of the wealthiest men in the country (Mr. W. L. Moody, of Texas), to pay $3,000,000 for the New Company's stock immediately, to apply all available earnings to non-can restorations for 7 years, and at the end of 7 years to pay into the Company, as a contribution to surplus, whatever balance might be necessary to restore the non-can benefits in full.* On the PDC figures, that was an offer to pay something over $18,000,000 for the Company, of which $15,000,000 would go to non-can policyholders, or to reserves for their claims, and $3,000,000 would go to creditors and stockholders.** As the Committee's figures

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*Tr. 809-10, 817-18, 847-51; App. D-9-10.

**The PDC took the value of the non-can liabilities as $22,000,000, a total that is reached approximately by adding up the figures in the sixth column on Chart I (J. S. No. 584, op. p. 12). If we deduct from the total the figures for the 7 calendar years following

were too conservative, our $18,000,000 figure is an overstatement; but as the PDC had not suggested even the remotest possibility that non-can restorations could be completed in 7 years, Mr. Moody's offer for the equity of the Company could hardly be figured at less than $10,000,000 in sum total.

The Commissioner ruled that the offer could not be entertained because of the "option to mutualize".

(3) The fact (if it were a fact) that, on two other bases of value mentioned by two members of the PDC in their testimony before the Commissioner, the PDC might have arrived at less than $3,000,000 (and maybe zero) as the December 31, 1948, value, would at best be an academic argument. The PDC did not use those other bases of value, but found them inapplicable (Tr. 143, 146-47; Ex. 28, p. 25); the propriety of using them has not been litigated; and both of them ignore the most fundamental factor in determining value—the future prospects of the business. No estimate which simply multiplies 1948 earnings by a number—and no rule of thumb that values a company at so many dollars per $1,000 of insurance outstanding—can have the slightest relevance unless the 1948 figures are weighed in the light of reasonable future expectations—the probable trend of earnings or volume of business, as the case may be.

Arguments pertaining to price

While we have attacked in several particulars the methods used by the PDC to get at values, and at the

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Mr. Moody's offer (1951-57), we get $6,926,000; and deducting that from $22,000,000 we get $15,074,000 as the non-can liabilities which, if the Committee's figures turned out to be accurate, Mr. Moody's company would have had to pay at the end of 1957.

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underlying figures from which it derived values, our arguments on those matters are quite subordinate to those that relate to *price.*

The first of the arguments pertaining to price relates to the application of the 10% compound discount rate to reduce the estimated 1974 value of the equity, which on the PDC's figures is $27,700,000, to a 1948 value of $3,000,000. We will restate our position on this point for the sake of clarity:

(1) It is a violation of due process under the 14th Amendment for a public authority to order or sanction a taking of property at a contingent future date, for a price equal to its value at a date many years before.

(2) Putting the matter in terms of figures, it is a violation of due process to fix, by whatever means or methods, a price of $3,000,000 plus interest—to be paid when the property is taken sometime after 1974—in the face of a finding that the expected 1974 value of the property is $27,700,000.

(3) It is a violation of due process for a public authority to fix or sanction a *present* taking of property (or, as here, a taking "as of December 31, 1948," a past date) for no consideration other than a conditional promise to pay its present (or, as in this case, a past) value at a remote and contingent future date, subject to conditions that may never occur.

(4) It is a violation of due process for a public authority to say to a citizen: Your property today is worth $25,000,000, less a contingent liability of $22,000,000 that must be discharged out of earnings, so that the net present value is the difference—$3,000,000.

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When your $22,000,000 liability has been discharged, and the value of your company is at least $25,000,000 without any deduction, we will buy it and pay you $3,000,000 plus interest.

Those propositions seem so clear from the authorities, and from the standpoint of common sense, fair dealing and public morality, that they seem almost impossible to answer; and Appellees have not been able to answer them.

The Commissioner does not make any attempt to answer them. He calls our figures for future values "rather fantastic"* (Comm. 28). But the only figure that relates to the present point is the $27,700,000 figure mentioned above; and that is not our figure. That is the 1974 value, upon a 10% compound discount basis, of the PDC's own estimates of earnings from 1974 to the end of time.

Faced with a line of constitutional authority that is unanimous to the effect that, when property is taken, it must be paid for at the date of taking or within a reasonable time thereafter, the Commissioner does not deal with the point or even mention it. Nor does he mention the closely

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*Appellees also attack certain figures that we took from the brief of Appellants below, to contrast the PDC's estimates of earnings with what we understood to be the earnings that actually were realized by the New Company in the years from 1949-1952 (see J. S. No. 584, p. 34).

Whether the figures are correct, and whether they present a true picture, are matters of controversy between opposing counsel in the court below. We need not become involved in that controversy, because the figures can be disregarded without impairing the points that we intended to make, *viz.*, (1) that the amounts available for non-can restorations have exceeded the PDC's estimates by substantial amounts; and (2) that the earnings of the New Company and its volume of business have run far above the PDC's estimates. If the case comes before the Court for argument, both those points can readily be established by reference to the New Company's annual reports, which are matters of public record.

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parallel case of *Matter of New York Title & Mortgage Co.*, 171 Misc. 489, which we cited (J. S. No. 584, p. 25).

The New Company does deal with the point, devoting a little over one page to it (NC. 22-23), with an argument truly remarkable for its lack of content. As we read the argument, it embodies the following propositions:

> (1) That the courts below construed the Rehabilitation Agreement as authorizing the PDC to write a mutualization plan under which, immediately upon its adoption, the Old Company and its stockholders were denuded of all rights except (a) to receive the 1948 value of their equity in the dim distant future, should the plan go into effect, and (b) to get their equity back if the plan should fail.
>
> (2) That it was proper for the PDC to take December 31, 1948, as the valuation date, because it ordered that interest should commence to accrue from that date.
>
> (3) That the rights of the Old Company stockholders are those of people whose trustee has sold property and taken back a purchase money mortgage to secure payment of the purchase price.*

Taking the third proposition first, one has to have a vivid imagination to conceive of a situation in which a trustee could lawfully sell property for $3,000,000, payable if, as and when—by the elimination of a $22,000,000 contingent obligation—the property has acquired a value of $25,000,000; or a situation in which a trustee, having

*There is an additional argument, in the last sentence (NC. 22-23), that we deal with separately below.

found that a property will be worth $25,000,000 in 25 years, sells it now for $3,000,000, to be paid with non-compensatory interest at the end of the 25 years.

The second proposition in the New Company's argument—that the 1948 date was proper because interest was made to run from that date—proves too much. Upon that proposition any date could be defended, provided interest started to run from that date.

The first proposition is put in terms of a construction of the Rehabilitation Agreement. But the Rehabilitation Agreement does not contain a word about dates of valuation; and Appellees do not here and did not below—nor did the courts below—refer to any provisions of that Agreement that had to be construed to determine the right valuation date. The only issue was and is: May one charged with determining a fair price for property taken by State authority fix the price at present-day value and provide for payment in the distant future? The question is purely a due process question, and has nothing to do with a construction of the Rehabilitation Agreement.

Appellees' statement that upon approval of the Plan the Conservator will turn over the stock of the New Company to voting trustees, and the interest of the stockholders in the earnings of the New Company will then cease, simply begs the question. All it does is state what Appellees have tried to accomplish by adopting a Plan that does everything that words can do to cut off the rights of the Old Company and its stockholders *ab initio*. They have proposed and approved a Plan that calls for immediate transfer of the New Company's stock to voting trustees and defines the duties of the voting trustees in such manner as to negative any possible fiduciary duty to the Old Company stock-

holders. But the fact that they have so meticulously labored to cut off the stockholders' rights does not prove, or even help to prove, that what they have tried to do is constitutional or, specifically, that the fixing of 1948 as the valuation date and indefinite deferment of payment is constitutional.

Thus it will be seen that the New Company's argument under the title "Valuation as of 1948" is no more than a series of assertions as to what they have attempted to do by means of the Plan of Mutualization, plus an assertion that the California courts *necessarily* held that what they did was authorized by the Rehabilitation Agreement. As an argument in defense of the 1948 valuation date, it proves exactly nothing. Like the Commissioner, the New Company fails to address itself to the authorities which hold that when property is taken for public use (and *a fortiori* for private purposes), it must be paid for at the time of taking or within a reasonable time thereafter (J. S. No. 584, p. 25). They do not cite—and they did not cite to the California courts—a single decided case that supports their position. Nor could they, because their position is untenable. It is a marvel that Appellees have been able to maintain it in four State tribunals.

We come now to the last sentence of the New Company's argument in support of the 1948 valuation date. It reads (NC. 22-23):

> "To estimate earnings from 1974 on and then to attempt to determine their value in 1974 by discounting them to that date, as advocated by Appellants, means that the risk between 1948 and 1974 that distant earnings will not emerge as predicted would be thrust upon the life policyholders instead of being borne by Appellants who improvidently

caused the non-can deficit which prevents earlier payment."

Before analyzing this remarkable argument, we note that we *have not* advocated estimating earnings from 1974 on, and then *attempting* to determine their value in 1974 by discounting them at 10% compound interest. We have no such proposition to sustain. All we have done is to take the PDC's figures at face value, and by application of arithmetic, to state the 1974 value of the New Company's stock in accordance with the PDC's findings. It is $27,700,000; and we draw the conclusion that a price of $3,000,000 plus interest will be grossly confiscatory in 1974, on the PDC's own figures.

Now comes the New Company and says that we cannot ask it to pay a price for its stock in 1974 which bears some reasonable relation to estimated value at the time of payment, because to do so would put on the policyholders (*i.e.*, on the New Company itself) the risk that "earnings will not emerge as predicted". That risk, as the argument runs, should be borne by the Appellants, because they "improvidently caused the non-can deficit".

There is nothing in this record to show that the non-can deficits were "improvidently caused" by the management of the Old Company—much less its stockholders—rather than by the fact that a nation of generally healthy people were overrun by a catastrophic depression, and that many of them, in California and elsewhere, found it more difficult to get employment than to have accidents or get sick, and live on their accident and health insurance. But let us assume the contrary. Let us suppose that the management of the Old Company did improvidently cause the non-can deficit. Is that a reason for marking down the 1974

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value of the New Company stock from $27,700,000 to $3,000,000 plus interest?

The policyholders (*i.e.*, the New Company) did not need to be protected from the risk that earnings would not emerge as expected. Their obligations were conditional upon earnings emerging *at least* as expected; and so they took no risk. Moreover the New Company has conceded, just two pages after the above argument, that "the stock [of the New Company] was valued by the Price Determination Committee on the assumption that there was *no risk* that earnings would not emerge between 1948 and 1973 sufficient to restore non-can benefits" (NC. 24-25; emphasis ours).

But let us go on and suppose that there was a risk that the stock might not be worth $27,700,000 in 1974. By what process of reasoning do Appellees reach the conclusion that the way to transfer that risk is to discount the $27,700,000 estimate on a compound interest basis back to 1948—to mark down the value of $27,700,000 to $3,000,000 plus interest? The thread of that thought, if there is one, eludes us.

Unlike the Commissioner, the New Company does take notice of the *New York Title* case; but it dismisses the case with a quip, in a footnote as follows (NC. 22):

> "The Plan did not provide for an option as was the case in *Matter of New York Title Mortgage Co.*, 171 Misc. 489, 13 N. Y. S. 2d 214, cited by Appellants (No. 584, p. 25)."

The distinction will not do. In the *New York Title* case the Superintendent asked court approval of a plan to sell certain properties to yet unknown purchasers for certain prices, upon receipt of approvals by a certain percentage of

the creditors affected. The time for getting the necessary consents was the balance of the current year (1939) and thereafter until the Superintendent called the deal off on 90 days notice to the reorganization managers. Stockholders objected on the ground, among others, that the Superintendent was proposing to give an option to unknown persons for an indefinite period of time. The court sustained the Superintendent on his power to create such an "option" with court approval, but ruled against him on the fixing of the price in advance, saying (171 Misc. at 495-96):

> ". . . Although the price for which the Superintendent proposes to make the sale to assenting creditors must be deemed to be fair and reasonable as of the present time—no one having disputed the allegation in the Superintendent's petition that the price is fair—it may well be that during the period for which the Superintendent permits the option to remain in effect the price may, by reason of change of circumstances, become inadequate. This circumstance is, however, insufficient in itself to require the denial of the application. The rights of non-assenting creditors and stockholders may be adequately protected through the addition of a provision that the agreement of purchase shall not take effect unless the price therein specified shall have been approved by the court (on notice to all creditors and stockholders) as fair and reasonable *as of the time when the agreement would otherwise become effective through the receipt of sufficient assents from creditors desiring to participate.* In this way all non-assenters will be assured that assets in the hands of the liquidator will not be disposed of for less than their fair and reasonable value at the time of such disposal." (Italics in original)

In the *New York Title* case the postponement of the "taking" of the stockholders' property was for a compara-

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tively short time—part of a year plus a further period that the Superintendent might terminate on 90 days notice. Yet the court refused to sanction a fixing of prices on the basis of values in advance of the time of sale. The case is precisely in point.

Failure of the PDC to take account of accumulations of surplus and the earnings thereon

In our Jurisdictional Statement (pp. 27-28), we pointed out that the PDC, in estimating the earnings of the New Company from 1949 to 1974 available for non-can restorations (Chart I), deducted the sum of $190,000 from each year's earnings, in order that that amount might be added to the corporate surplus, instead of going into non-can reserves; and that, in addition, the PDC had excluded from each year's earnings all earnings resulting from the investment of the $190,000 annual additions to surplus, and all amounts earned on the reinvestment of earnings produced by the gradually increasing surplus. The Committee estimated that the $190,000 per year addition to surplus, together with the compounded earnings thereon, would produce by 1974 a total increase in the New Company's surplus of $7,260,000, that being the estimated amount necessary to keep pace with the projected levels of business.

The substance of our argument is that, when the PDC came to value the capital stock of the New Company, it did not take account of the 1949-74 earnings that were thus going into surplus to increase the stockholders' equity, and did not take account of the $7,260,000 surplus of which the stockholders would be the beneficial owners at the estimated time of purchase of the stock in 1974; whereas, if proper account of either those earnings or the resulting surplus had been taken, the PDC—according to its own

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declared methods of valuation—would have had to find the 1974 value of the Company at $7,260,000 more than its figures showed, and the 1948 discounted value at $3,500,000 more than it found, or a total of $6,500,000.

Appellees have replied to our argument by asserting that the $7,260,000 surplus as of 1974 was in fact taken into consideration in the PDC's estimates of earnings from 1974 to 2000 A.D., upon which the valuation of the stock was based; that interest on the increased surplus is included in the 1974-2000 figures of estimated earnings; and that, therefore, we are asking that that factor of value be counted twice—once as capitalized earnings and once as surplus.*

We cannot so read the record. The testimony that Appellees cite seems quite ambiguous (Tr. 545-47); and Appellees' assertion is inconsistent with Chart II (J. S. No. 584, op. p. 12). Just as Chart I excluded all earnings on amounts added to surplus from 1949 to 1974, and showed earnings on capital and surplus at the unvarying figure of $347,000 —which is 3% on the capital and surplus of some $11,000,000 existing at the end of 1948—so Chart II employs the same unvarying figure year by year. If the PDC was indeed taking into account the subsequent earnings on the 1974 increase of surplus, and on additions to surplus after 1974, it concealed the fact most effectively, by retaining in Chart II the same $347,000 figure, year after year, for earnings on capital and surplus.

However, in the limited time that we have to prepare this brief, we cannot make the study that would be required

*The Commissioner goes on to make the gratuitous statement that "This error permeates many of their figures, including their table on page 28" (Comm. 26). That is only one of the numerous exaggerations in the Commissioner's brief; as a matter of fact, the alleged error neither "permeates" nor affects in any way *any* figures in our Jurisdictional Statement *except* the table on page 28.

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for a positive assertion of what the facts were. Nor do we need to do so for present purposes because, even if we accept the Appellees' argument, the PDC still failed to make a proper evaluation of the stockholders' interest in the surplus that was to accumulate from 1949 to 1974.

The basic assumption of the PDC's method of valuing the New Company's stock—by discounting the sum total of earnings after 1974—was based upon the premise that the earnings from 1949 to 1974 would all be required for the restoration of non-cans, so that no part thereof would redound to the benefit of stockholders. However, it appears, and in effect it is admitted, that that premise was contrary to fact. Earnings not made available for non-can restorations were transferred to surplus and, according to the estimate, would increase the value of the stockholders' equity by $7,260,000 in 1974, the estimated date when the stock would be purchased and the price paid.* That gradually increasing surplus was an element of value in every year from 1949 to 1974, and—on the Committee's theory that future earnings are discounted *from the year in which they are derived,* the PDC should have discounted from year to year in the period 1949-1974 the amounts accruing to increase the stockholders' equity—just as they did for the earnings from 1974 to 2000.

It is not sufficient to take the accumulated increase of surplus in 1974, assume that its only bearing on price is derived from subsequent earnings thereon, and then practically *extinguish* the value of $7,260,000 by discounting the future 3% return thereon back to 1948 on a 10% compound basis.

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*We have referred uniformly to the year 1974 as the estimated date of non-can restorations, to avoid the unnecessary verbiage that would be required to make each reference to both 1974 and the alternative year of 1971.

$250,000 per year price adjustment

On pp. 23-24 of its Motion, the New Company attempts to meet our point that the $250,000 per year price adjustment, in the event of restoration of non-cans prior to the PDC's estimated date, was grossly confiscatory. They refer to the adjustment as a "bonus", and imply that the stockholders were lucky to get it—first because "The Committee would have been justified in valuing the stock and fixing the price without any provision for augmentation." Just why that is so is left to the imagination. As in so many other instances in Appellees' Motions, assertion takes the place of argument.

The other reason why the stockholders will be lucky to get the "bonus" (if they get it) is that the PDC might have provided, but did not provide, for a comparable *deduction* in the event that non-can restorations were *not* completed until after 1973.

We might reply to that argument with the Scotch proverb: *Nothing in the world is made better by the fact that it could be worse.* But Appellees concede (NC. 25) that it was the PDC's assumption (and, their argument implies, a correct one) "that there was no risk that earnings would not emerge between 1948 and 1973 sufficient to restore non-can benefits"; and so a provision for the suggested deduction was plainly not necessary.

With respect to the $250,000 per year adjustments, we stand on the argument in our Jurisdictional Statement (pp. 30-33), to which Appellees have not made a serious answer.

Interest

Our objections to the interest provisions of the Mutualization Plan are stated briefly in our Jurisdictional State-

ment, pp. 29-30. Under the decisions of this Court, which we cited, the points are almost self-evident.

Appellees' reply (NC. 24-25) is that interest on the purchase price of the New Company's stock was properly figured at a "no risk" rate, because there *is no risk* that earnings will not emerge between 1948 and 1973 sufficient to restore non-cans (Compare p. 22 of the same Motion, where the risk is so serious that it must be shifted to stockholders who improvidently caused the non-can deficits); that interest is properly payable at maturity, instead of currently, because the Rehabilitation Agreement prohibits current payments (Apparently no constitutional principle can survive excision by the Rehabilitation Agreement); and that the cases we cite have no application, because they deal with present right to a sum of money "which is not the situation here" (Compare p. 22 of the same Motion, where the 1948 valuation date is defended on the ground that the New Company comes under an immediate obligation to buy its stock, subject only to postponement of the time of payment until the conditions have been fulfilled!).

It will be seen that the Appellees' arguments respecting the interest provisions of the Plan are not weighty.

POINT IV.

The issues presented on this appeal, including the issues of due process which, apart from the appeal, would be reviewable by certiorari, are of sufficient importance to require decision by this Court.

Appellees urge that the questions on which we seek review are not substantial questions of federal law. To the New Company the case is "episodic", like the Indian burial

case, *Rice* v. *Sioux City Memorial Park Cemetery, Inc.*, 349 U. S. 70, where certiorari was dismissed as improvidently granted, upon the ground that the State law had been amended to prohibit cemetery companies from refusing to bury Indians, thus depriving of all significance, except to the immediate parties, the decision below upholding one cemetery company's refusal to bury a particular Indian.

It is a far cry, we submit, from the *Cemetery* case to one which presents, in the dimensions of the present case, some of the most mooted questions of current constitutional law—questions of the proper standards and procedures for valuation of property in corporate reorganizations; the proper scope of judicial review in such proceedings; and whether decisions of this Court subsequent to *Ben Avon* are to be understood as diminishing the traditional right of independent judicial review in State proceedings wherein property is taken at a price claimed to be confiscatory.

Appellees erroneously state (NC. 29; Comm. 31) that we are complaining because the California courts did not afford a "trial de novo". What we are seeking—whether it take the form of a "trial de novo" or not—is an independent judicial review of the Commissioner's determination of the fairness of the Mutualization Plan to stockholders, rather than merely a finding that the PDC and the Commissioner had before them "substantial evidence" bearing on values, and did not act arbitrarily. As we point out in our Jurisdictional Statement (pp. 37-40), anything less than full and independent judicial determination of value or price is unknown in reorganization proceedings in this country, with the two exceptions of the ICC railroad reorganization cases and the SEC public utility holding company simplifications, where special considerations of public policy are present—which are not present here in the remotest degree.

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Appellees state (NC. 30) that we base our argument in this respect on *Ben Avon* and *St. Joseph Stockyards Co.* v. *United States,* 298 U. S. 38. We do rely on those cases, among others that we have cited. However their doctrine may have been limited by subsequent decisions in cases involving public regulation or where the public interest is primarily involved, there is nothing in the subsequent cases to suggest that the doctrine has been limited so that it no longer applies to cases not involving public regulation, where private property is taken and confiscation is claimed.

When Appellees urge that *Ben Avon* and *St. Joseph Stock Yards* "have been limited to their special facts" (NC. 30), they tender to this Court a constitutional issue of considerable importance.

Conclusion

This case involves constitutional questions of importance, which this Court should hear and determine on appeal. If for any reason the jurisdiction of the Court on appeal is not properly invoked, the Court in its discretion should grant a writ of certiorari to review those questions.

Respectfully submitted,

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February 29, 1956.

Supreme Court, U.S.
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No. 585.

In the Supreme Court of the United States

October Term, 1955

THE PACIFIC MUTUAL LIFE INSURANCE COMPANY OF CALIFORNIA, a California corporation, SAMUEL K. RINDGE, and WILLIAM H. JACK,

Appellants,

vs.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, F. BRITTON McCONNELL, Insurance Commissioner of the State of California, as Liquidator of The Pacific Mutual Life Insurance Company of California, and PACIFIC MUTUAL LIFE INSURANCE COMPANY, a California corporation,

Appellees.

On Appeal From the Supreme Court of the State of California.

BRIEF IN OPPOSITION TO MOTIONS TO DISMISS.

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Appellees.

On Appeal From the Supreme Court of the State of California.

BRIEF IN OPPOSITION TO MOTIONS TO DISMISS.

STATEMENT.

Appellees' principal claims are: (a) this court is without jurisdiction; and (b) even if this court has jurisdiction appellants are foreclosed by contract and res judicata. Appellees make a number of other claims which add up to the contention that no substantive constitutional questions are presented because appellants are really being unjustly enriched, not being despoiled. Appellees do not distinguish the cases relied on by us as showing that substantial constitutional questions are presented; nor do appellees cite any cases to the contrary. Finally, appellees assert that, if substantive constitutional questions are presented, appellants are not entitled to have the case heard and determined on the merits; but the assertion is dogmatically made without supporting argument.[1]

[1]References to Jurisdictional Statement are to that filed in No. 585. References to Appendices are to those in said Jurisdictional Statement.

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A.
JURISDICTION.

1.
The Order of the Insurance Commissioner Is a State Statute Within the Terms of 28 U.S.C., §1257(2).

(a) Mutualization Involves Charter Amendment, and Charter Amendment Requires Legislation.

Appellees shut their eyes to the fundamental principle of corporation law: "The right to do business as a corporation * * * is not a natural one."[2] Naturally, therefore, appellees ignore the truism that the right to incorporate or amend articles of incorporation depends upon legislative grant.

In earlier days legislatures granted special charters and amended them by special legislation. But whether a charter be granted or amended by special act of the legislature, or articles be filed or amended pursuant to general laws, the acts of incorporation or amendment necessarily are legislative; and it matters not whether the acts are performed by the legislature itself or are performed by its agents.

These elementary principles are controlling here, for mutualization takes place only when the articles of incorporation of an insurance company with capital stock are amended to eliminate the capital stock.

Section 11526 of the Insurance Code of California, therefore, provides that a plan of voluntary mutualization shall include "appropriate proceedings for amending the insurer's articles of incorporation to give effect to the acquisition, by said insurer * * * of the outstanding

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[2]*Coombes v. Getz* (1932), 285 U. S. 434, 447.

shares of its capital stock and the conversion of the insurer from a stock corporation into a nonstock corporation * * *".

The Plan of Mutualization itself contains provisions for the amendment of New Company's articles of incorporation. [Ex. 15, §IV.]

(b) In Approving the Plan of Mutualization the Insurance Commissioner Acted as an Agent of the Legislature.

Indubitably, when the California legislature provided a procedure for voluntary mutualization, which included the approval of the Plan of Mutualization, by the Insurance Commissioner, it conferred legislative power on the Insurance Commissioner.

In the leading case of *Lord v. Equitable Life Assurance Society* (1909), 194 N. Y. 212, it is held that when the legislature authorizes a "course of procedure whereby a charter may be amended" an amendment made in accordance with the procedure "is the act of the Legislature." The *Lord* case is followed in *Breslav v. Light and Power Co.* (1936), 249 App. Div. 181, 184 (aff'd 273 N. Y. 593); *Casper v. Kalt-Zimmers Mfg. Co.* (1915), 159 Wis. 517; and *Bingham v. Savings, etc. Company* (1927), 101 N. J. Eq. 413 (aff'd 102 N. J. Eq. 302).

To the same effect are *Rippel v. Prudential Ins. Co.* (1914), 85 N. J. L. 395, and *In re Prudential Insurance Co. of America* (1913), 82 N. J. Eq. 335.

All of the above cases except the Wisconsin case and one of the New Jersey cases are cited in our Jurisdictional Statement (p. 42). Appellees say the cases are not in

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point, but cite no case to the contrary (N. C. p. 14).[3] The cases are, however, in point. Indeed the *Lord* case is precisely in point, and the other cases are closely in point.

In the *Lord* case, the directors, with the authorization of the holders of the majority of the stock had, by virtue of the statute, amended the charter by conferring upon the policyholders the right to vote for a majority of the directors. In holding that the charter amendment was not within the reserved power of the legislature, the court was called upon to and did pass on the question whether the action of the directors was legislative.

On that point the court said:

> *"We mention, only to overrule, the position that the legislature did not amend the charter by authorizing the directors to amend it.* When the legislature authorizes a course of procedure whereby a charter may be acquired or amended, action in conformity thereto does not create the charter or make the amendment, but both come into existence through the operation of the statute. *The amendment is the act of the legislature the same as the charter itself, and neither has existence except as conferred by statute."* (p. 238). (Emphasis added throughout.)

Nothing could be more explicit than the language of the New Jersey courts in dealing with mutualization under a statute similar to the California statute for voluntary mutualization, except that under the New Jersey statute the valuation is made by the Chancellor and not the Insurance Commissioner.

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[3]New Company's motion to dismiss is cited as "N. C.," and the Insurance Commissioner's motion as "I. C."

In *In re Prudential Insurance Company of America, supra,* it is said:

> *"The enactment * * * constitutes the Chancellor of this state as a legislative agent through whose instrumentality such proceeding shall be administered."* (82 N. J. Eq. at 336.)

In *Rippel v. Prudential Ins. Co., supra,* it is said that the *appraisement of stock in a* mutualization proceeding *"was a matter of legislative discretion, to be performed by a legislative agent."* (85 N. J. L. at 398.)

The other cases cited above, and American Jurisprudence, are scarcely less explicit.[4]

Appellees say that *Belden v. Union Central Life Insurance Company* (1944), 143 Ohio St. 329, is contrary to the cases relied on by us (N. C. p. 14). But that is not so. The *Belden* case only construes the provisions of the Ohio state constitution prohibiting the delegation of legislative power as being confined to matters of legislative policy (*i.e.,* as requiring standards to be stated in the statute), but as not precluding a statute authorizing

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[4]The passage quoted in the text from the *Lord* case, except the first sentence, was quoted with approval in *Casper v. Kalt-Zimmers Mfg. Co. supra,* where the Wisconsin Court also said: "An amendment to a charter is a legislative act—just as much so when made in pursuance of a provision in its charter or in a general law as by special act." The *Lord* case was also cited with approval in *Bingham v. Savings, etc. Company, supra,* where the New Jersey Court of Equity said: "Where the legislature authorizes a course of procedure whereby a charter may be amended, action in conformity thereto does not make the amendment, but it comes into existence through the operation of the statute. The amendment is the act of legislature, the same as the charter and neither has existence except as conferred by the statute." In *American Jurisprudence,* vol. 13, p. 230, it is said: "The legislature may authorize corporators or members of a corporation to amend a corporate charter in compliance with constitutional and statutory requirements, but though the amendment is effected by the vote of the directors or stockholders, it is really the act of the legislature * * *."

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the Insurance Commissioner to pass upon the fairness and equity of a voluntary plan of mutualization.

(c) The Cases Sustaining Jurisdiction on Appeals From Orders of State Utilities Commissions Are on All Fours Here.

Just as in earlier times corporate charters were granted and amended by special legislation, so railroad rates were fixed and extensions and improvements authorized by the legislatures themselves. Later the fixing of rates and the authorization of extensions and improvements were delegated to state utilities commissions. In our Jurisdictional Statement (p. 3) we rely on decisions of this Court holding that orders of state utilities commissions fixing rates or authorizing extensions involved the exercise of delegated legislative power, and, therefore, are state statutes within 28 U. S. C., §1257(2). Appellees cite *Standard Scale Co. v. Farrell* (1919), 249 U. S. 571, to the contrary. (N. C. pp. 18, 19.) In that case, as the Court pointed out, the functions of the state superintendent under review were "educational, and at most, advisory."[5] Appellees also cite five other cases (N. C. p. 14). Although appellees do not say so, in all of those cases the appeals were dismissed without opinion. An examination of the records shows that the cases are as wide of the mark as the *Farrell* case. Moreover, it requires no little assurance to suggest that such orders, without opinion, overrule the carefully considered cases cited in our Jurisdictional Statement. We submit that the cases cited by us are on all fours here.

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[5]If appellees' interpretation of the case were correct, the decision would be out of line with many decisions of this Court, both earlier and later in time. See Davis (author of a treatise on Administrative Law); *Ripeness for Judicial Review,* 68 Harvard Law Review 1326 at 1337-8 (1955).

2.

The State Mutualization Statutes, as Construed by the State Supreme Court, Present Questions Reviewable on Appeal Under 28 U. S. C., §1257(2).

(a) The Point Was Raised in the Courts Below.

Appellees assert that the point was not raised in the California courts.

Appellees refer to the allegation in paragraph XXII of the Petition for Mandate: "Said Findings and Order of said Commissioner deprive petitioners, and each of them of property without due process of law, contrary to the provisions of the Constitution of the State of California and the Fourteenth Amendment to the Constitution of the United States." (N. C. p. 11). Appellees say these allegations were insufficient to raise the point. But appellees omit to refer to the sentence following the quoted allegation: "In this respect petitioners here refer to their Points of Error hereto attached and presented with this petition." It is hard to understand the failure to refer to this sentence. Not only is the sentence quoted in our Jurisdictional Statement (p. 40) but the only reference in the entire Petition for Mandate to the Points of Error is in that sentence. Besides, the summary of the Points of Error in our Jurisdictional Statement shows that not only the point made by us in this court as to the construction and application of the mutualization statutes, but also the supporting arguments here made, were made in the courts below (Juris. State. pp. 40-41).

(b) Appellees Do Not Meet Our Arguments.

Appellees virtually limit themselves to arguing that the Insurance Commissioner, although held by the state supreme court to have "acted as a judge in his own case",

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was justified on the ground of necessity. Our argument to the contrary was only cumulative. But appellees do not attempt to meet it directly. Instead they cite cases in all of which there was a public interest in upholding the particular proceeding, and either no other tribunal could be authorized to act, or prompt action was necessary (see N. C. p. 31; I. C. p. 31). But none of those conditions obtained here. Mutualization was for the benefit of the management, or at most the policyholders, and not for the benefit of the public (Juris. State. pp. 29-32, 51-52). Approval of the Plan by the Insurance Commissioner in the summer of 1950 was not a matter of public necessity. The proceeding could well have been continued, and meanwhile an impartial tribunal, such as the superior court, could have been provided by the legislature and thus made the practice in California correspond to that in New Jersey in cases of voluntary mutualization or in California, itself, in cases of involuntary mutualization.[6]

Whether or not it was necessary for the Insurance Commissioner to act as a judge in his own case, it cer-

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[6]In *State ex rel. Miller v. Aldridge* (1925), 212 Ala. 660 where all the members of a state administrative board had a conflicting interest, the court found that the matter was one with which "the public is not primarily concerned," and refused to permit the board to act on the ground of necessity, but relegated the parties to the legislature for a change in the law. The same thing was done in *State, etc. v. Crane* (1873), 36 N. J. L. 394. See also *Craft v. Davidson* (1920), 189 Ky. 378. Furthermore legislation for full judicial review, or the granting of full judicial review by the California courts under existing legislation, would have removed the constitutional infirmities in the proceeding so far as they related to the Insurance Commissioner being a judge in his own case. (*Hill v. State* (1927), 174 Ark. 886; *Hitt v. State* (1928), 149 Miss. 718; *Brooks v. Town of Potomac* (1928), 149 Va. 427; *State v. Gonzales* (1939), 43 N. M. 498.)

tainly was not necessary to constitute a P. D. C. with ties of interest with the management. Nor was it necessary for P. D. C. to carry on its investigations in secret, keep no records, and report a Plan of Mutualization (including a complicated trust indenture, which deprives appellants of the incidents of their ownership for thirty-five years) without supporting data.[7] Nor was it necessary for the Insurance Commissioner to approve the plan without exercising his own discretion.[8] Nor was it necessary for the California courts to put their *imprimatur* on the plan without weighing the evidence.[9] In short,

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[7]In *Law v. Charter Institute of Patent Agents* (1919), Ch. D. 276 at page 293 it is said: "A late Lord Justice one of great learning and wide experience—Lord Justice Farwell—once stated that he could not trust the whole bench of bishops to do justice under such conditions. With a respect for the episcopate as profound as that of the Lord Justice I adopt his language, in sharing to the full his distrust of justice administered by a tribunal sitting in private, unassisted and untrammelled by the salutary rules regulating procedure and the admission of evidence obtaining in these courts, uncontrolled by the invigorating and corrective criticism provoked and stimulated by publicity and finally wrapping up its findings in a secret communication to the department which appointed it."

[8]In *United States ex rel. Accardi v. Shaughnessy* (1954), 347 U. S. 260, it is said: "It is important to emphasize that we are not here reviewing and reversing the *manner* in which discretion was exercised. If such were the case we would be discussing the evidence in the record supporting or undermining the alien's claim to discretionary relief. Rather, ***we object to the Board's alleged failure to exercise its own discretion,*** contrary to existing valid regulations." (p. 268). (Juris. State. p. 44.)

[9]"It is also probably not without significance that despite many opportunities to do so, the Supreme Court has never expressly overruled *Ben Avon*. The Supreme Court has done a great deal to make the doctrine innocuous in situations where it could do the most damage. But it is as if the Court had concluded that it would be wise to retain the case in its armory of implements, against the day when some exceptional situation might demand its application." Jaffe: ***Administrative Law*** (1953), p. 617 (See also, Juris. State. p. 45.)

the state supreme court in construing the state mutualization statutes denied appellants a fair and open hearing by an impartial tribunal; in other words denied them their day in court.

But, regardless of whether appellants were entitled to full judicial review, on any rule of review the California courts should have ordered that the writ issue, because the record affirmatively shows that the valuation was arrived at by guess work, and a gift of $30,000,000 of appellants' money is being made to New Company, and appellants are otherwise being deprived of due process (Juris. State. pp. 19-32).

3.

Titles, Rights, Privileges, and Immunities Under the United States Constitution Were Especially Set Up or Claimed in Conformity With 28 U.S.C., §1257(3).

Our Jurisdictional Statement shows that substantial questions of substantive and procedural due process were claimed in the California courts and are presented by this appeal. (Juris. State. pp. 46-50, 52.) We made an alternative application for certiorari. (Juris. State. p. 53). Appellees make no effort to meet our alternative application for certiorari except by advancing the arguments herein referred to and shown to be without support in law or fact.

B.
CONTRACT AND RES JUDICATA.

1.
The Rehabilitation Agreement Was a Contract in Form Only.

Appellees assert that appellants not only are foreclosed by contract but are attempting to claim constitutional rights as a result of their own wrong in breaching their contract (I. C. p. 23).

These assertions are without foundation.

In our Jurisdictional Statement we show that the Conservator could not contract with his own agency, and he could not and did not undertake to execute the rehabilitation agreement until after and pursuant to the order of December 4, 1936. (Juris. State. pp. 34-36.)

The rehabilitation agreement was merely a plan of rehabilitation in the form of a contract. By its order on August 11, 1936, the court directed the Conservator to present *a plan of rehabilitation.* (Juris. State. p. 7.) The rehabilitation agreement was submitted to the court pursuant to the order of August 11, 1936. Section 1043 of the Insurance Code authorizes the Conservator, who has seized a delinquent insurance company, to rehabilitate it by entering into a rehabilitation agreement. On the face of it, the statutory provision would appear to refer only to rehabilitation agreements with third persons. But on appeal from the order of December 4, 1936, it was held that the language of the statute authorized rehabilitation agreements between the Conservator and corporations

organized by him to rehabilitate the business of a seized company. The rehabilitation agreement here, nevertheless, was no more than a plan of rehabilitation. As the California Supreme Court said, referring to its approval of the order of December 4, 1936: "The legality of the seizure and the lawfulness and propriety of *the plan of rehabilitation* have already been upheld by this court." (*Pacific Mutual v. Carpenter* (1939), 13 Cal. 2d 306, 309.) Indeed, the Insurance Commissioner, in his brief in the appellate court, refers to the rehabilitation agreement as being *a plan of rehabilitation "which takes the form of an agreement"* and *"takes its validity from the order of court of December 4, 1936."* (emphasis added). (Fold. 3, pp. 8, 9.)[10]

The idea of a hydraheaded Conservator getting a meeting of minds by having one of his tongues speak for the stockholders and the other two tongues for the creditors and policyholders respectively was apparently a little incongruous even for appellees until they found themselves in this, the court of last resort.

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[10]The remoteness from a true contract is further illustrated by the provisions of the rehabilitation agreement that upon its approval by the court all policyholders who did not affirmatively reject reinsurance within 75 days should nevertheless be legally bound (par. 24).

2.

Paragraph 20 Relative to Mutualization[11] Did Not Limit the Duties of the Insurance Commissioner in the 1950 Proceeding.

It is not clear whether appellees claim (1) that the provisions of paragraph 20 of the rehabilitation agreement relative to mutualization dispensed with anything but a *pro forma* hearing before the Insurance Commissioner, or (2) that the provisions of paragraph 20 restricted the Insurance Commissioner to determining only whether P. D. C. had been constituted in accordance with the provisions of the paragraph, and had reported the plan of mutualization in good faith (N. C. p. 18; I. C. pp. 12, 17). It makes no difference, however which position appellees stand on.

(a) Appellees Rely on the Opinion of the Appellate Court Which Is a Nullity.

Appellees rely on the opinion of the District Court of Appeal (N. C. pp. 18, 13; I. C. pp. 12, 17, 23-4). But as counsel must well know, under California law the granting of a hearing by the state supreme court after decision by the appellate court vacates the decision of the latter court and renders its opinion a nullity. (*Estate of Scott* (1949), 90 Cal. App. 2d 21, 24; *Estate of Kent* (1936), 6 Cal. 2d 154, 156; *Estate of Stierlen* (1926), 199 Cal. 140, 144; *McDonough v.*

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[11]The relevant provisions of Paragraph 20 are set forth in our Jurisdictional statement (p. 33).

Goodcell (1939), 13 Cal. 2d 741, 745.)[12] This is true because hearings are granted largely to avoid confusion in the law of the state. Where hearings are granted, the opinions of the appellate court are, therefore, not even officially reported.

(b) The State Supreme Court Did Not Hold That the Duties of the Insurance Commissioner in the 1950 Proceeding Were Limited by the Provisions of Paragraph 20.

There is no suggestion in the opinion of the State Supreme Court that the duties of the Insurance Commissioner in the 1950 proceeding were limited by the provisions of paragraph 20 as claimed by appellees.

Furthermore, the failure of the state supreme court to adopt the portion of the opinion of the appellate court relied on by appellees constitutes a repudiation of it.[13]

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[12]In *Estate of Scott* it is said: *"In re Smith's Estate,* 85 ACA 365 [a decision of the District Court of Appeal] is a nullity, the Supreme Court having granted a hearing after the decision of the District Court of Appeal. Thus the opinion of the District Court of Appeal was void and of no force and effect." In *Estate of Kent,* it is said: "When such an order of transfer is made, the opinion and decision of the District Court of Appeal is no more effective as a judgment than if it had not been rendered".

[13]See the language used by the appellate court and additional language used by the state supreme court quoted in our Jurisdictional Statement (p. 15, note 6).

(c) The Advance Consent Did Not Bind the Insurance Commissioner as an Administrative Officer.

Paragraph 20 of the rehabilitation agreement (relevant portions of which are quoted in our Jurisdictional Statement p. 33) specifically undertakes only to give advance consent by the Conservator on behalf of the stockholders; and paragraph 25 (which is quoted in full in our Jurisdictional Statement p. 34) specifically provides that the Insurance Commissioner is bound by the provisions of the rehabilitation agreement "only in his capacity as such Conservator or as Liquidator of Old Company," and "all undertakings or obligations of the Conservator are made only in his said capacities and to such extent as he had authority to make the same * * *."

The Conservator, and the Insurance Commissioner as an administrative officer, are different juristic persons (*Evans v. Superior Court* (1939), 14 Cal. 2d 563, 573-4; *Hise v. McColgan* (1944), 24 Cal. 2d 147, 156-8).

The Insurance Commissioner admitted in the state supreme court that the advance consent was not binding on him as an administrative officer (Fold. 3, I. C. Reply to Pet. for Hear. pp. 18-19).

The advance consent of the Conservator in behalf of the stockholders under Section 11526(b) of the Insurance Code did not limit the duties of the Insurance Commissioner as an administrative officer under Section 11526(c) and Section 11527 any more than it limited the directors in determining whether or not to adopt the

plan under Section 11526(a) (and the directors were nominees of the Conservator until the voting trust statute was passed in 1937), or the right of the policyholders to accept or reject the plan under Section 11526(d) (and the Conservator was trustee for the policyholders as well as the stockholders).

See Jurisdictional Statement pp. 33-34 note 20.

3.

The Order of December 4, 1936 Was Not Res Judicata as to the Duties of the Insurance Commissioner in the 1950 Proceeding.

The gist of appellees' claim is that the order of December 4, 1936 is res judicata as to the *construction* of the provisions of paragraph 20 of the rehabilitation agreement and conclusively determines that the Insurance Commissioner acting under Sections 11526(c) and 11527 in 1950 was in duty bound only to determine whether P. D. C. acted arbitrarily (See N. C. pp. 15-18; I. C. pp. 17, 23-4).

(a) The Order of December 4, 1936 Merely Approved the Rehabilitation Agreement.

The order of December 4, 1936 [Ex. 8] in general language *approved* the rehabilitation agreement and each and every part thereof; and in the words of the state supreme court affirming the order, reserved "jurisdiction over the entire proceeding." (10 Cal. 2d at p. 322.) The word *mutualization* does not appear in the order. Nor is there any reference in the order to the provisions of paragraph

20 relating to mutualization. Moreover the state supreme court, in affirming the order, mentions *mutualization* only once and then only in making a factual summary of the terms of the rehabilitation agreement. In that connection the state supreme court says: "Ultimate mutualization, in the event the policyholders so elect is also provided for." (10 Cal. 2d at p. 322.)

(b) The State Supreme Court Held That the Order of December 4, 1936 Was Res Judicata Only as to the Validity of the Rehabilitation Agreement.

The distinction between an order being res judicata of the *validity* of an instrument and res judicata of its *construction* is an obvious one. (*Church v. Wilson* (1912), 152 App. Div. 844, 851-2, aff'd 209 N. Y. 553.)

The state supreme court dealt with *validity* only and expressed itself in the following unambiguous language:

> "* * * the VALIDITY of all portions of the *rehabilitation agreement,* including the provision for advance consent *is res judicata*" (Appx. A, p. 12a).

How could the state supreme court have decided any more?

At the hearing before the Insurance Commissioner counsel for New Company introduced in evidence the order of December 4, 1936, and the rehabilitation agreement *"for the purpose of establishing the res adjudicata, if you please, of the* APPROVAL *of the rehabilitation and reinsurance agreement."* (Fold. 1, Vol. I, pp. 27-8.)

The only question argued by appellees and considered by the state supreme court was whether the order of December 4, 1936 was res judicata as to the *validity* of the provisions of paragraph 20 of the rehabilitation

agreement relating to mutualization. This is affirmatively shown by the majority opinion, as well as both dissenting opinions (Appx. A, pp. 12a, 16a, 43a, 44a, 50a). Anticipating the point appellees make here, we had undertaken to show that the order of December 4, 1936 was not res judicata as to the order of the Insurance Commissioner made in 1950 (Fold. 3, Op. Br. pp. 222-6, 229-31). Appellees ridiculed our argument. They conceded the point, but declared it was entirely irrelevant (Fold. 3, I. C. Reply to Pet. for Hear. pp. 18-19). The relevant thing, according to appellees, was whether the *provisions* of paragraph 20 had been judged *valid*. Appellees' claim before the Insurance Commissioner and in the state courts was that the provisions of paragraph 20 being valid, the P. D. C. acted solely as appraisers and, therefore, as a matter of procedural law, without regard to res judicata, the Insurance Commissioner in 1950 was limited to determining whether P. D. C. had acted arbitrarily or fraudulently (Fold. 3, I. C. Br. pp. 92-5; Fold. 1, pp. 951-966). Appellees concede that the state supreme court rejected their argument (I. C. p. 11, note 9).

P. D. C., of course, did not act merely as appraisers but exercised all the functions of a district judge, together with the functions of creditors' and stockholders' committees in a reorganization proceeding (Juris. State. p. 44).

(c) The California Cases Since 1936 Hold That the Order of December 4, 1936 Is Res Judicata Only as to the Validity of the Rehabilitation Agreement and Not as to Its Construction.

The cases subsequent to the decision affirming the order of December 4, 1936, have referred to the order of December 4, 1936 and its affirmance as merely adjudicating the VALIDITY of the rehabilitation agreement. In *Carpenter v. Pacific Mutual* (1939), 13 Cal. 2d 306, 313, the court referred to "the decision of this court upholding the *validity* of the rehabilitation order." In *Caminetti v. Pacific Mutual* (1943), 22 Cal. 2d 344, 351, 352, the court said, referring to the order of December 4, 1936: "The *lawfulness* of the plan of rehabilitation was upheld on appeal;" and in the same case (p. 359) the court said: "The order of December 4, 1936 *does no more than approve* the rehabilitation agreement and the prior actions of the Commissioner and provide for its enforcement." (emphasis added).

The California courts have also recognized that in making the order of December 4, 1936, the superior court did not, and in affirming the order, the state supreme court did not undertake to *construe* the provisions of paragraph 20 of the rehabilitation agreement. Thus in *Caminetti v. Pacific Mutual, supra,* the Supreme Court undertook to construe part of paragraph 20. This it did to ascertain whether such paragraph permitted the Liquidator to transfer the stock of New Company to voting trustees. (See 22 Cal. 2d at pp. 357-9). In an earlier case (*Caminetti v. Pacific Mutual* (1943), 22 Cal. 2d 77),

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which involved the rights of policyholders who had not expressly accepted reinsurance, the court said: "The main controversy involves the *construction and application of the rehabilitation and reinsurance agreement,* dated July 22, 1936, the *approval of which* by the superior court *was affirmed* by this court in *Carpenter v. Pacific Mut. Life Ins. Co.,* 10 Cal. 2d 307." (pp. 79-80). In *Garrison v. Pacific Mutual* (1943), 83 Cal. App. 2d 1, the District Court of Appeal construed the rehabilitation agreement to determine whether New Company was liable to pay interest to creditor claimants who had declined to take reinsurance. The court said: *"The correct interpretation of Article 17 [of the rehabilitation agreement] is the solution of the present controversy."*

(d) In the Present Case the State Supreme Court Did Not Construe the Order of December 4, 1936 as Extending to the 1950 Proceedings.

The point is discussed under B 2 (b), *ante,* pages 14-15.

4.

The Order of December 4, 1936 Could Not Have Been Held to Limit the Duties of the Insurance Commissioner in the 1950 Proceeding Without Violating Due Process.

There was no justiciable controversy in 1936 as to the duties of the Insurance Commissioner under Sections 11526(c) and 11527 in 1950. In 1936 it was not known and could not have been ascertained what duties, if any, the statutes in force after 1946 would impose on the Insurance Commissioner; by 1950 Section 11526(c) might well have provided for a hearing by the superior court in cases in which all the stock of the company being mutualized was held by the liquidator of a delinquent

company,[14] as is provided for in involuntary mutualization proceedings in California, and voluntary proceedings in New Jersey. Consequently in 1936 it was not within the judicial power to construe the rehabilitation agreement as passing upon the duties of the Insurance Commissioner under Sections 11526(c) and 11527 as they might or might not be after 1946.

In *In re Opinion of the Judges* (1926), 50 S. D. 324, the court, which was authorized to render advisory opinions, refused to render such an opinion on a question assuming future changes in the law, saying:

> "Manifestly we cannot at this time render any opinion as to the general constitutionality or validity of future legislative action, the exact terms of which necessarily rest in speculation and conjecture." (p. 326).

There having been no justiciable controversy, the state supreme court could not, consistently with due process, have held that the order of December 4, 1936, was res judicata as to the construction of the provisions of paragraph 20. (*Postal Telegraph Cable Co. v. Newport* (1917), 247 U. S. 464, 473-6.)[15]

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[14]As a matter of fact many of the Insurance Code sections relating to voluntary mutualization, including both sections 11,526 and 11,527, were altered between December 4, 1936 and 1950: §11525 was amended in 1937; §11526 in 1937 and 1945; §11527 in 1937; §11528 in 1937; §11529 in 1937 and 1947; §11529.5 was added in 1947; §11530 was amended in 1937 and 1947; §11531 was amended in 1937; and §§11532.1-11532.8 were added in 1941. Section 1094.5 of the Code of Civil Procedure, providing the standards under which the order of the Insurance Commissioner was judicially reviewed, was not enacted until 1945, and was amended in 1949.

[15]To the same effect are *Hansberry v. Lee* (1940), 311 U. S. 32; *Heaton v. Southern Ry. Co.* (1954), 119 F. Supp. 658; *Romeo v. Western Express Co.* (1943), 45 N. Y. S. 2d 297; *Schwegmann v. Neff* (1950), 218 Ind. 63; *Jetter v. Brown* (1951), 107 N. Y. S. 2d 856.

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5.

The Order of December 4, 1936 Could Not Have Been Held Res Judicata Even as to the Validity of the Provisions of Paragraph 20 Without Denying Appellants Their Day in Court.

In our Jurisdictional Statement we urge that res judicata could not consistently with due process have been made applicable even to the validity of the provisions of paragraph 20 (Juris. State. p. 16, note 7). Appellees' argument and authorities are restricted to an attempt to show that point is not well taken.

But appellees overlook the express reservations as to validity in subdivision (f) of paragraph 20.[10] As said in *Freeman on Judgments* (1925), 5th Ed., Vol. 2, §704, p. 1487, "in such cases the express reservation itself becomes *res judicata*." Paragraph 20, relative to mutualization, is the only paragraph in the entire instrument which contains a reservation as to validity or anything else. When a

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[10]Subdivision f of paragraph 20 is as follows: "If the provisions of this paragraph 20, or of any one or more of the sub-paragraphs hereof, should be contrary to law or illegal or void, then such paragraph, subparagraph or subparagraphs, shall be null and void, and shall be deemed separable from the remaining covenants and agreements in this agreement contained; and shall in no way affect the validity of any of the remaining provisions of this agreement." In *Case v. Los Angeles Lumber Products Co.* (1939), 308 U. S. 106, the contention was made that proceedings under 77B were controlled by a prior contract. The contention was answered by the court as follows: "No conditions precedent to enjoyment of the benefits of §77B can be provided except by the Congress. To hold otherwise would be to allow reorganizers to rewrite it so as to best serve their own ends." (p. 129).

court has expressly reserved an issue for future determination, obviously it can not properly be said by some other court at a future time that the judgment in the original action is res judicata as to the issue reserved. (*Stark v. Coker* (1942), 20 Cal. 2d 839, 843.)[17]

None of the cases cited by appellees deal with reservations in the underlying documents. Nor do any of appellees' cases involve situations in which there was no justiciable controversy. Nor do any of appellees' cases conflict with *Hansberry v. Lee* (1940), 311 U. S. 32 and other cases cited by us (Juris. State. p. 32, Note 18) holding that this court will reexamine documents to ascertain for itself whether the application of res judicata involves a deprivation of due process. Indeed in *Angel v. Bullington* (1947), 330 U. S. 183, 190, a res judicata case cited by appellees, it is said "a state court cannot sterilize federal claims by putting on the adjudication a local label."

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[17]It was natural that there should be reservations in paragraph 20. In 1936 possible mutualization was more than ten years in the future, and obviously had nothing to do with the rehabilitation of the business of Old Company. That was accomplished by scaling down non-can liabilities. (Juris. State. pp. 8, 30). There were no allegations in the pleadings in the 1936 proceeding relative to the provisions for mutualization in paragraph 20. (Appx. A, pp. 46a-47a). At most, therefore, the approval of paragraph 20 by the general language of the order of December 4, 1936, was *pro forma* and insufficient to constitute res judicata as to validity even without the reservations. (*Lawlor v. National Screen Service Corp.* (1955), 349 U. S. 322, 327, Note 12).

C.
QUESTIONS SUBSTANTIAL.

1.
Our Arguments Stand Unanswered.

Appellees do not face up to our positions. Thus, appellees assert that P. D. C. was enabled to forecast earnings beginning twenty-five years in the future and thence to perpetuity (N. C. p. 21) but appellees ignore the uncontradicted affirmative evidence to the contrary (Juris. State. pp. 19-21) and disregard the authorities to the contrary (Juris. State. p. 21, note 9; pp. 46-7). Appellees assert that it was proper to select the discount rate by formula because the Insurance Commissioner was an expert (N. C. pp. 28-9), but appellees ignore the authorities holding that rates cannot be arrived at by *expertise* alone (Juris. State. pp. 21-2, 47) and disregard the fact that the Insurance Commissioner had no *expertise,* because neither he nor any other insurance commissioner in California had ever valued an insurance company in a mutualization proceeding; and he did not even attempt to exercise his own discretion. (Juris. State. p. 44.) Appellees assert that no vested interests were involved because the order of the Insurance Commissioner was permissive only (I. C. p. 21; N. C. p. 19) but they ignore the uncontradicted affirmative evidence that the compulsion resulted from the order of the Insurance Commissioner alone (Juris. State. pp. 32-7), and disregard the rule of law that even though the compulsion might have resulted from both the order of December 4, 1936, and the order of the

Insurance Commissioner taken together, this Court, on the question of due process, is concerned with the totality of the state action (Juris. State. p. 36).[18] Appellees assert that Old Company, representing the stockholders' interest, is not the equitable owner of New Company (N. C. p. 18) but ignore the California decisions since 1936, including the decision of the state supreme court in the pending case, that the Conservator was, and the Liquidator is, trustee for policyholders, creditors and stockholders alike (Appx. A, p. 2a). Appellees assert that creditors come ahead of the stockholders (I. C. p. 5) but omit to state that the creditors' claims aggregate less than $560,000 (Fold. 2, pp. 140-1). Finally, appellees are silent as to our principal arguments that substantial questions are presented (Juris. State. pp. 46-53); and do not distinguish the supporting cases cited by us (Juris. State. pp. 46-50), or cite any cases to the contrary. In short, appellees fail to meet our arguments.

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[18]Additional cases in which state action has been held violative of due process because of a condition arising from earlier state action, which has itself become final, include: *Brinkerhoff-Faris Trust & Savings Co. v. Hill* (1930), 281 U. S. 673 (decision of state supreme court, otherwise unobjectionable, held to violate procedural due process because of its effect in the light of earlier decisions of the same court); *Cumberland Coal Co. v. Board of Revision* (1931), 284 U. S. 23; *Iowa Des Moines National Bank v. Bennett* (1931), 284 U. S. 239; *Hillsborough Township v. Cromwell* (1940), 326 U. S. 620, 623 (tax assessments, otherwise unobjectionable, held to violate substantive due process where assessments on other comparable property (which had become final) had intentionally been made on a more favorable basis of valuation); *Houston v. Eidson* (1954), 119 Fed. Supp. 778; *Montgomery v. Eidson* (1954), 123 Fed. Supp. 292 (orders remanding convicts to prison, otherwise proper, held to violate due process when made after final orders of other state courts granting writs of habeas corpus).

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2.

Appellees Are Being Despoiled, Not Unjustly Enriched.

(a) The Policyholders Made No Contribution in 1936.

Appellees assert that the participating life policyholders made a contribution of almost $5,000,000 to the reorganization and suggest that the policyholders other than non-cans are therefore entitled to a windfall profit of $30,000,000 on mutualization (N. C. p. 6). This assertion obviously attempts to contradict the terms of the rehabilitation agreement and the order of December 4, 1936, approving it which gave the par and other policyholders, except non-cans, full insurance in a solvent company, but gave them no more. The assertion is also without any basis in fact. The alleged contribution was merely a bookkeeping operation, and was specifically so treated in the Rehabilitation Agreement [Ex. 9, Par. 6] and in the Order of December 4, 1936 [Ex. 8, Par. 11]. Besides, neither the articles of incorporation nor the by-laws of Old Company gave par policyholders a lien or charge on the reserves carried on par policies. Nor did the par policies themselves provide for a lien or charge on the reserves [Fold. 1, pp. 571-6]. Consequently, as a matter of law, the reserves carried on par policies were general assets of Old Company. There is no conflict in the authorities on that point.[19] Moreover, if par policyholders made the alleged contribution of almost $5,000,000 to the reorganization, why were all policyholders other than non-cans treated alike?

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[19]See Vance: Law of Insurance (3rd Ed. 1951), p. 279; *State ex rel. Ellis v. Union Central Life Ins. Co.* (1910), 13 Ohio Cir. Ct. N. S. 49, 22 Ohio Cir. Dec. 262, 265-6; *Mutual Benefit Life Ins. Co. v. O'Brien* (Ky. 1909), 116 S. W. 750; *Royal Highlanders v. Wiseman* (1941), 140 Neb. 28, 38-9; 44 *C. J. S.* 674.

(b) P. D. C. Went on a "Frolic of Its Own" to the Injury of Appellants.

Appellees assert that on any method of valuation except that used by P. D. C. the stockholders would have received nothing. That is not so. In pretending to determine investment value, P. D. C. disregarded the methods approved by the courts and went on a "frolic of its own." It is elementary that investment value is determined by ascertaining earning capacity, capitalizing the same at an appropriate rate, and deducting the indebtedness (*Consolidated Rock Products Co. v. Du Bois* (1941), 312 U. S. 510; 55 Harv. L. Rev. 125 at 133 (1941); *"The New Schoolmaster in Finance,"* 40 Mich. L. Rev. 625 at 632 (1942)). If the figures of P. D. C. should be accepted (average earnings for twenty-five years after 1948 claimed to have been accurately determined; a 3% rate used because there was practically no risk), the value in 1948 after deducting non-can liabilities was not $3,000,000 but $21,000,000 (Fold. 3, Op. Br. p. 98). As though this were not enough P. D. C. prepared a plan of mutualization which is not a plan of mutualization at all but an option to buy should the stock (on the basis of salvage values) become worth $30,000,000 more than the purchase price and interest. P. D. C. also prepared a trust instrument, as part of the Plan, which deprives appellants of the incidents of the ownership of their stock for thirty-five years.

If, instead of being preoccupied with keeping the management in control, and speculating on a pattern of future earnings and arbitrarily assigning earning figures year by year to perpetuity, P. D. C. had concentrated on trends in the industry and the position of New Company in the industry, and had made appropriate statistical and econ-

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omic surveys as to the future interest rate, and had undertaken to estimate earnings for the "foreseeable future," P. D. C.'s estimate of earnings for the first year in the future (*i. e.,* for 1949) would not have been 50% of actual earnings; and when that fact came to light at the hearing before the Insurance Commissioner (Fold. 1, pp. 319 *et seq.*), if P. D. C. had not been stultified by ties of interest with the management, it would have confessed that its entire valuation was a sham; and appellees would not be here suggesting that P. D. C. was generous to the stockholders, without being just to the policyholders, in valuing the stock at $3,000,000 in the face of average actual net earnings for 1953 and 1954 (the last years for which figures are available) of approximately $3,000,000, instead of less than a third that amount, as arbitrarily fixed by P. D. C. [Ex. 28, pp. 9-10]; nor would appellees be here attempting to justify the Plan which contains no unconditional promise to pay, and deprives appellants of the incidents of the ownership of their stock for thirty-five years.

D.

QUESTIONS IMPORTANT AND RECURRING.

In our Jurisdictional Statement we show that, unless the decision of the state supreme court is reviewed on the merits, serious conflicts will result among lawyers, judges, accountants, tax officials and others daily concerned with the valuation of all classes of property both in and out of court; that turnpike promoters and oil and mining operators exercising the power of eminent domain, will be enabled to subject real property to options to purchase for fifty years at the land's present value; that the construction of the mutualization statutes of California, New York, and twelve other states will be placed in doubt; that mutualization as a device for corporate control will

be encouraged; and the unconstitutionality of compulsory mutualization will be thrown in doubt (Juris. State. pp. 46-53).

The only attempt appellees make to meet our argument, if indeed it can be called an attempt, is to assert, by way of *non sequitur*, that a decision of the highest court of a state will not ordinarily be reviewed on the merits unless the questions presented are likely to recur (N. C. p. 32).

CONCLUSION.

Appellees' arguments constitute mere rationalizing. The real reason for the reorganization in 1936, as stated in the majority opinion and by the Insurance Commissioner (Juris. State. p. 10; I. C. p. 8) was that the Commissioner "concluded a plan of reorganization which could not be destroyed by future action or non-action by shareholders was necessary * * *". It has not been denied by appellees that the controlling purpose was not the public good or the benefit of the policyholders, but was the personal aggrandizement of the reorganizers who themselves, as officers of Old Company, were fiduciaries. It plainly appears, also, that the proceedings before the Insurance Commissioner in 1950 were little more than a ritual. It plainly appears, also, that the California courts sacrificed the constitutional rights of appellants on the altar of "polite presumptions."

We urge that the motions to dismiss should be denied.

Respectfully submitted,

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February 27, 1956.

DAR

FILED
MAR 2 1956
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

No. 584

FRANK GENTLES, *et al.*, *Appellants*,

v.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, *et al.*, *Appellees*.

No. 585

THE PACIFIC MUTUAL LIFE INSURANCE COMPANY OF CALIFORNIA, *et al.*, *Appellants*,

v.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, *et al.*, *Appellees*.

APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

REPLY TO BRIEFS IN OPPOSITION TO MOTION TO DISMISS

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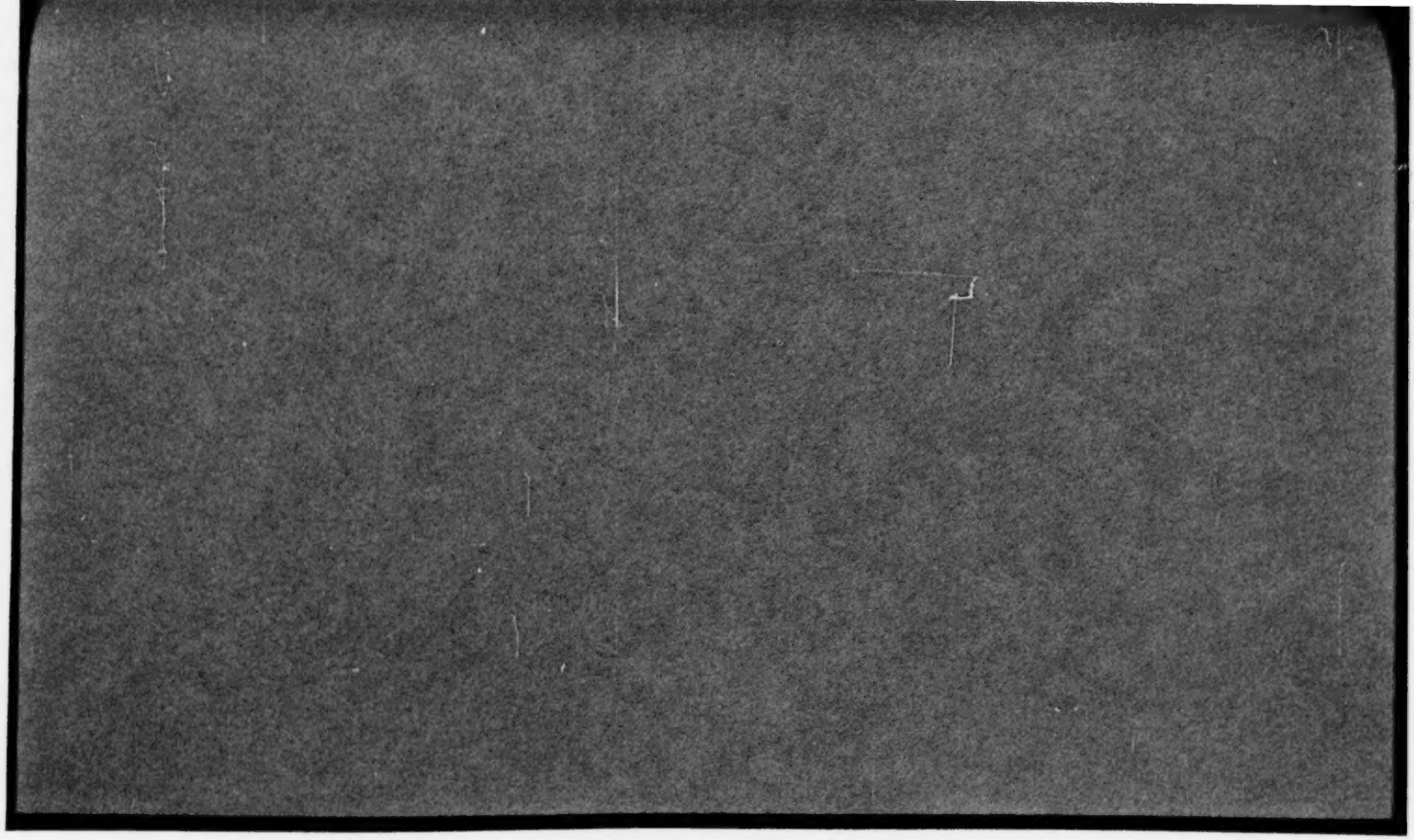

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REPLY TO BRIEFS IN OPPOSITION TO MOTION TO DISMISS

The briefs in opposition to appellees' motion to dismiss advance only one argument not raised in the jurisdictional statements and discussed in appellees'

motion to dismiss.* The new argument is that the California Superior Court in 1936 did not pass on the provision of the Rehabilitation Agreement by which the Conservator consented in advance to the plan of mutualization contemplated by the Agreement, that in any event the stockholders could not have appealed on that point in 1936, and hence that the court below erred in applying *res judicata* (Br. Opp. No. 584, pp. 7-19). While we hesitate to burden the Court with further papers in this case, we may be warranted in exposing, briefly, the fallacy of appellants' position.

The California Supreme Court explicitly held that "the validity of all portions of the rehabilitation agreement, including the provision for advance consent, is res judicata" (App. A13).** This application of *res judicata* is not, as we pointed out in our Motion to Dismiss, a violation of due process unless it is a mistake "so gross as to be impossible in a rational administration of justice." *Chicago Life Ins. Co.* v. *Cherry*, 244 U.S. 25, 30. No stricter standard is im-

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* Since the jurisdictional question is at the threshold, it may be worthwhile noting that, in our view, the briefs in opposition fall far short of showing that this case is within the appellate jurisdiction of this Court. See N. C. Motion to Dismiss, pp. 11-14. None of the record references cited by appellants show that the validity of the California statutes involved was drawn in question below, and, indeed, appellants' briefs seem almost to concede this point. Moreover, appellants' arguments that the action of the Insurance Commissioner is a "statute" are based largely on state court decisions, despite the fact that appellants in No. 584 recognize that the jurisdictional question "cannot turn on the categories employed by the State courts" (Br. Opp. p. 25).

** The California Supreme Court also held that, apart from *res judicata*, the Conservator's consent in advance to the Plan of Mutualization was valid under California law (App. p. A13).

posed by the cases cited by appellants, (Br. Opp. No. 584, p. 11), for they make it clear that this Court examines non-federal grounds of decision such as *res judicata* only to determine whether they are "plainly untenable" or "so insubstantial as to be in effect an evasion of the constitutional issue." *Ward* v. *Love County*, 253 U.S. 17, 23; *Memphis Gas Co.* v. *Beeler*, 315 U.S. 649, 654.

The holding of the court below that the validity of the provision of the Rehabilitation Agreement for the Conservator's advance consent is *res judicata* has a sound basis. On September 25, 1936, the Insurance Commissioner presented the Rehabilitation Agreement to the California Superior Court for approval. *Neblett* v. *Carpenter*, 305 U.S. 297, 300. The Agreement contained an explicit provision in Section 20(a) that the Conservator "agrees to consent and hereby consents as the holder and owner of the stock of New Company" to the plan of mutualization contemplated by the Agreement (App., p. F27). The Superior Court issued an order "which directed all interested persons to show cause why the Agreement ... should not be approved," and at a "hearing, which lasted from October 19 to December 4 [1936], many officers, stockholders and policy holders" were heard. *Neblett* v. *Carpenter*, 305 U.S. 297, 300.

On December 4, 1936, an order was entered by the Superior Court approving "each and all of the terms and conditions" of the Rehabilitation Agreement and directing the Conservator "fully and faithfully to perform, carry out and discharge each and all of the obligations, terms, conditions and covenants on his part to be performed under the terms" of the Agreement (Ex. 8, Pars. 13 and 15; see *Neblett* v. *Carpenter*,

305 U.S. 297, 300). That order "forever barred and enjoined [all persons] from making hereafter any complaint in respect of the said Rehabilitation and Reinsurance Agreement, or any provision or provisions thereof" (Ex. 8, Par. 22; see App. p. A8). The order was affirmed by the California Supreme Court (*Carpenter* v. *Pacific Mutual Life Ins. Co.*, 10 Cal. 2d 307, 74 P. 2d 761) and ultimately by this Court. *Neblett* v. *Carpenter*, 305 U.S. 297.

Against this background, the court below held that since the same parties or their privies were involved in both proceedings, the validity of every provision of the Rehabilitation Agreement, including the provision for advance consent, is *res judicata* (App. p. A8). The court reasoned that "The basic issue before the Court when the agreement was submitted for approval was the propriety of each of its provisions, and the determination of that issue is conclusive as to every matter which might have been urged to sustain or defeat its determination" (App. p. A9). Far from being "an evasion of the constitutional issue," this ruling is consistent with a long line of prior California decisions, as well as with decisions of other courts. See, *e.g.*, *Price* v. *Sixth District Agricultural Assn.*, 201 Cal. 502, 258 P. 387 (1927); *Krier* v. *Krier*, 28 Cal. 2d 841, 843, 172 P. 2d 681 (1946); 30 Am. Jur., Judgments, § 178; Developments in the Law—Res Judicata (1952) 65 Harv. L. Rev. 818, 840-841.

Appellants argue that the circumstances of this case should have led the court below to refuse to apply *res judicata*. First, they urge that the "separability

clause" in Paragraph 20(f) of the Agreement* somehow "made it unnecessary" for the court in 1936 to determine the validity of the Conservator's advance consent to the plan of mutualization (Br. Opp. No. 584, p. 7). The argument, however, ignores both the language of Paragraph 20(f) and the nature of a separability clause. Paragraph 20(f), like any separability clause, would have become operative only if some provision of Paragraph 20 were held void; that not having occurred, Paragraph 20(f) ceased to have further significance.** We know of no case—and

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* Separability clauses such as Paragraph 20(f) which are directed at a particular section of a contract or statute are increasingly common where the draftsman wishes to leave no doubt as to the separability of a given section and its parts. See Stern, "Separability and Separability Clauses" (1937) 51 Harv. L. Rev. 76, 125-128.

** Appellants' present argument was urged upon and rejected by the Trial Court which said:

> "I think they misconstrued the purpose of subparagraph (f). The purpose thereof was undoubtedly to enable the court in the proceeding had for the approval of Rehab either to approve the plan as a whole, or if it believed certain portions of paragraph 20 to be illegal, then to approve it with those parts deleted. In other words, the petitioners there said to that court: 'We ask you to approve this agreement as a whole, but if you cannot give your approval to it as a whole, we ask you to approve it, after deleting therefrom such portions of paragraph 20 as you find contrary to law.'
>
> "They thus submitted to the court by their petition the validity of all of the terms and conditions of paragraph 20, and when the court gave its approval of the agreement without finding any provision of paragraph 20 to be contrary to law, it, by its judgment, established the validity of each of the provisions of that paragraph, and it became an integral part of the approved agreement; subparagraph (f) had then served its purpose." (App. pp. C17-C18)

appellants cite none—suggesting that a separability clause weakens the effect of a judgment holding all the provisions of an agreement valid, and there is no logical reason why it should do so.

Second, appellants argue that the Conservator's consent in advance was not in issue in the 1936 litigation because of the provisions of Paragraph 25 of the Rehabilitation Agreement. Again the argument misconstrues the Rehabilitation Agreement. Paragraph 25, of which appellants quote only a part,* is entitled "Conservator Not Personally Liable", and it relates solely to that subject. What Paragraph 25 means is that Samuel L. Carpenter, Jr., the Conservator, shall not be personally liable if any action taken by him pursuant to the Rehabilitation Agreement is later successfully attacked. This exclusion of personal liability in Paragraph 25 could not, and did not, obviate the necessity of the court's determining in 1936 the validity of all of the provisions of the Rehabilitation Agreement, including the Conservator's consent in advance.

Third, appellants say that *res judicata* is inapplicable because an attack on the provisions for advance consent would have been held premature by this Court had it been made in the 1936 litigation. This contention,

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* The full text of Paragraph 25 is as follows:

"(25) No personal liability on the part of Samuel L. Carpenter, Jr. is assumed under this agreement, but he is bound by the provisions of this agreement only in his capacity as such Conservator or as Liquidator of the Old Company. All undertakings and obligations herein set forth as undertakings or obligations of the Conservator are made only in his said capacities and to such extent as he had authority to make the same, and the Conservator makes no warranty of his authority to make the same."

however, ignores the fact that the "validity of all of the provisions of the [Rehabilitation] agreement was put in issue by the petition" for its approval, and that the order of the California Superior Court in 1936 held valid "each and all" of said provisions and "forever barred and enjoined" all persons from thereafter attacking any of them, (App., p. A8).* It was open to the parties in that case to assert then, as they now do, that the advance consent of the Conservator was a deprivation of their constitutional rights, and to urge that they could not properly be denied the right to question the propriety of that consent at a later time.** Indeed, the attack upon the Rehabilitation Agreement in *Neblett* v. *Carpenter* itself was made *in limine*, and many of the issues there raised and determined by this Court were likewise related to the possible future effect of the Agreement. As a minimum, and even had this Court deemed the validity of the advance consent provision to be premature, there could have been no doubt as to the right of the parties to urge that the Superior Court's injunction should be modified to permit a later attack on that provision. Appellants' argument on prematurity simply ignores the conclusive character of the 1936 order and seeks to assert now that it did not mean what it plainly said.

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* The terms of the order and of the injunction completely deflate appellants' claim that they were "lulled into security" and that the "courts below have made the Rehabilitation Agreement a trap for the unwary" (Br. Opp. No. 584, p. 9).

** As the California Supreme Court said, "there was nothing to prevent the questions which are raised with regard to the validity of the rehabilitation agreement from being litigated in the proceeding which led to the order approving the agreement." (App. p. A12).

The heart of the matter is that the prior litigation approving all of the provisions of the Rehabilitation Agreement forecloses the basic claim made by appellants in this Court. Appellants indeed concede as much (Br. Opp. No. 584, p. 6), and underscore that fact by their strenuous efforts to avoid the force of *res judicata*. Policyholders, in accepting reinsurance twenty years ago and in purchasing new insurance since that time, have relied on the fact that the Superior Court's order meant what it said in barring all future attacks on any provisions of the Rehabilitation Agreement, including the mutualization option which gave them an opportunity to become owners of the Company. In the 1936 litigation, appellants might have challenged the provisions of the Rehabilitation Agreement binding the Conservator (and, through him, appellants) to consent to the price and terms of payment fixed by the plan of mutualization promulgated in accordance with the terms of the Agreement. They did not elect to make the challenge then; they may not do so now.

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No. 585.

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In the Supreme Court of the United States

October Term, 1955

THE PACIFIC MUTUAL LIFE INSURANCE COMPANY OF CALIFORNIA, a California corporation, SAMUEL K. RINDGE, and WILLIAM H. JACK,

Appellants,

vs.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, F. BRITTON McCONNELL, Insurance Commissioner of the State of California, as Liquidator of The Pacific Mutual Life Insurance Company of California, and PACIFIC MUTUAL LIFE INSURANCE COMPANY, a California corporation,

Appellees.

On Appeal From the Supreme Court of the State of California.

REJOINDER TO REPLY BRIEF.

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In the Supreme Court of the United States

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No. 585.

THE PACIFIC MUTUAL LIFE INSURANCE COMPANY OF CALIFORNIA, a California corporation, SAMUEL K. RINDGE, and WILLIAM H. JACK,

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Appellees.

On Appeal From the Supreme Court of the State of California.

REJOINDER TO REPLY BRIEF.

In its Reply Brief New Company says: "The California Supreme Court expressly held that 'the validity of all portions of the rehabilitation agreement, including the provision for advance consent, is res judicata.'" (p. 2.) From this New Company argues: "The heart of the matter is that the prior litigation approving all of the provisions of the Rehabilitation Agreement forecloses the basic claim made by appellants in this Court." (p. 8.) By "the basic claim" New Company means appellants' argument that, by holding the validity of the advance consent was res judicata, the state supreme court deprived appellants of their day in court.

1. The Claim as to the Advance Consent Is Not a Basic One.

This is an appeal from the 1955 judgment of the state supreme court affirming the judgment of the superior court denying a writ of mandate to vacate the 1950 order of the insurance commissioner. The questions presented are whether the order of the insurance commissioner and the judgment of the state supreme court deprive appellants of their property without due process of law for the reasons stated in our Jurisdictional Statement (pp. 4-6). The invalidity of the advance consent is not among the reasons stated.

In our Jurisdictional Statement we devote a line and a half of text (p. 46) and a portion of a twelve line note (p. 16, note 7) to the invalidity of the advance consent. In our Brief in Opposition we devote two pages to showing, in answer to appellees' arguments, that the order of December 4, 1936 could not have been res judicata as to the validity of the advance consent without denying appellants their day in court (pp. 22-23). This is the extent of our treatment of advance consent in the Jurisdictional Statement and Brief in Opposition filed in this Court prior to the filing of New Company's Reply Brief.

Plainly, the point as to advance consent is not a basic one.

2. The Point as to the Advance Consent Is Cumulative Only.

Even though the advance consent were valid, that circumstance would not be controlling here. Indeed, had the Liquidator, after full consideration of the plan, given present consent in 1950, on behalf of the stockholders, under the provisions of §11526(b), still the plan of mu-

tualization would have been waste paper if the insurance commissioner had not approved it under §11526(c), after a full hearing under §11527.[1]

Section 11526 governing voluntary mutualization calls for affirmative action by (a) the directors, (b) the stockholders, (c) the insurance commissioner, and (d) the policyholders. As shown in our Jurisdictional Statement and not denied by any one, the insurance commissioner conceded in the state supreme court that the advance consent given by the Conservator was only the consent called for by subdivision (b); and the consent of the stockholders is not the test of whether the plan satisfies the statutory standard of fairness, but that must be independently determined by the insurance commissioner. (Juris. State. pp. 33-34, note 20.) There was no dispute about either of those propositions before the insurance commissioner or in the state courts. New Company spent three weeks in the 1950 proceeding offering evidence in support of the plan. The insurance commissioner not only heard the evidence, but also explicitly stated that "the approval or disapproval of the Plan by the commissioner is under statutory rather than contract provisions," i.e. was governed by §11527 of the Insurance Code and not the provisions of the Rehabilitation Agreement. (Fold. 1, p. 6.) In reviewing the proceedings the state supreme court dealt with the hearing before the insurance commissioner on the same footing. (Juris. State. p. 15, note 6; Br. in Opp. p. 14.)

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[1]See, Folder three, Op. Br. p. 229.

3. New Company's Present Contention Is Unsupported by the Opinion of the State Supreme Court.

The present argument is but a revised version of the argument made in the motions to dismiss, i.e. the order of December 4, 1936 required the insurance commissioner in the 1950 proceeding to rubber stamp the plan of mutualization and not exercise his own discretion as to its fairness and equity. (Mot. N. C. p. 18; Mot. I. C. pp. 13, 17.) That argument has been shown to be based on the opinion of the appellate court which was repudiated by the state supreme court. (Our Br. in Opp. pp. 13-14.) Appellees have, of course, correctly quoted the statement from the opinion of the state supreme court relative to the validity of the advance consent being res judicata. But it is plain that the state supreme court did not (and could not consistently with due process) have construed the advance consent as limiting the duties of the insurance commissioner in 1950 in passing on the fairness and equity of the plan of mutualization. (Id. pp. 15-21.) As to that proposition New Company raises no question in its latest document.

In its Reply Brief New Company tries to meet our arguments by claiming that the reservations in paragraph 20 became *functus officio* upon the signing of the order of December 4, 1936. We anticipated and met that argument in our Jurisdictional Statement (p. 35) and the insurance commissioner conceded the point in the state courts. (Fold. 3, I. C. Br. p. 62.)

DAR

CONCLUSION.

It is hard to understand why New Company has traveled outside the Rules to reiterate a point that has already been demolished, particularly as the point is not a controlling one, and is of such a minor character as to be merely cumulative. It is, we believe, a measure of the unsoundness of appellees' motions to dismiss that New Company should make an eleventh hour effort to focus attention on non-essentials.

New Company says "appellants" concede their present point (p. 8). New Company cites Br. in Opp. No. 584, page 6. The reference does not bear out New Company. Besides it is not even claimed that appellants in No. 585, including Old Company which is the equitable owner of the stock of New Company, have made any such concession.

It is submitted that the motions to dismiss should be denied.

Respectfully submitted,

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March 6, 1956.

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HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 584

FRANK GENTLES, *et al.*,

Appellants,

—against—

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

APPELLANTS' MEMORANDUM ANSWERING THE "REPLY" OF APPELLEE PACIFIC MUTUAL LIFE INSURANCE COMPANY

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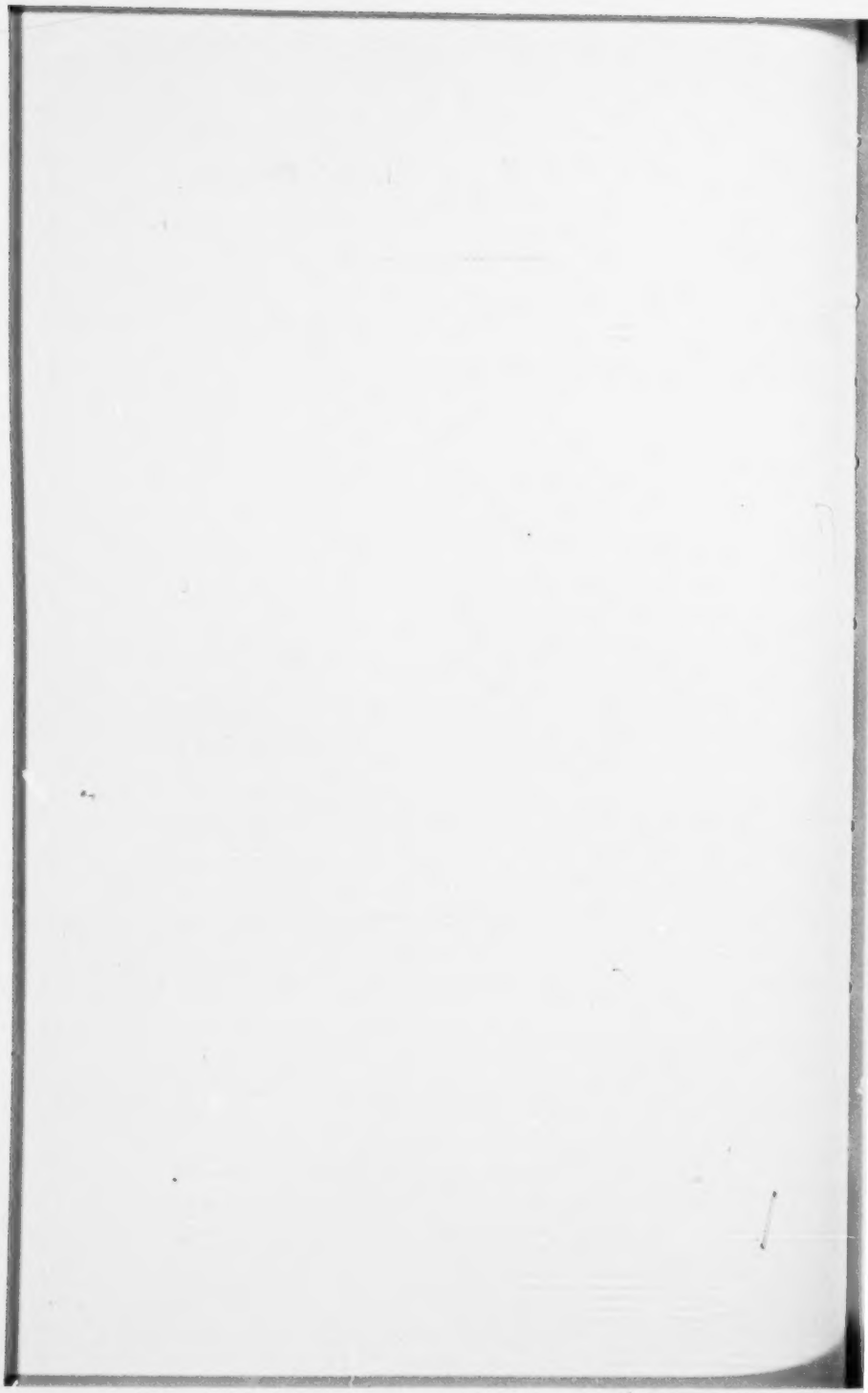

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New Company has filed a "Reply" to our Brief in Opposition to Appellees' Motions to Dismiss, and has stated therein (p. 8):

> "The heart of the matter is that the prior litigation approving all of the provisions of the Rehabilitation Agreement forecloses the basic claim made by appellants in this Court. Appellants indeed concede as much (Br. Opp. No. 584, p. 6), and underscore that fact by their strenuous efforts to avoid the force of *res judicata*."

We made no such concession. All we said at page 6 of our Brief in Opposition was that the *res judicata* argument was Appellees' only possible escape from the conclusion that

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Appellants' property has been taken in violation of the 14th Amendment. We then proceeded to show why *res judciata* in fact provided no such escape. (Br. Opp. No. 584, pp. 7-12.)

New Company's statement about "the heart of the matter" asserts a proposition that is plainly untenable. It amounts to arguing that a binding adjudication as to the fairness of a mutualization plan can be had ten years or more before the plan has come into existence. That argument goes far beyond the decision of the court below, which did not apply *res judicata* to the validity of the Commissioner's order approving the plan. Moreover, the argument proves too much. It amounts to saying that the 1936 proceedings so fixed the relationships and rights of all interested parties that, when the Commissioner was subsequently called upon to exercise his statutory function of passing on the fairness of a mutualization plan, his action is immune to *any* form of legal review as to *any* unconstitutional aggrievement such action might have inflicted, or *any* spoliation or injustice that might have ensued from it; and that *any* abdication of his statutory duties must go unquestioned. In fact, it amounts to a claim that our challenge to the Commissioner's order approving the plan of mutualization is not litigable.

The New Company is aware that there is an issue of *res judicata*, affecting Appellants' "basic claim", because at page 7 of its "Reply" it addresses itself to that issue. In attempting to meet our argument that the constitutionality of the advance consent was a question which—because it was premature—could not have been raised in 1936, New Company argues that Old Company stockholders could have raised the constitutional question in 1936 anyway, and

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urged that the 1936 order (which New Company calls "an injunction") be modified so as to reserve for later decision the constitutional issues that might be involved in an attack on that provision. The argument is absurd, since nobody has to give advance notice that he will assert and protect his constitutional rights if and when an infringement of them is attempted. The argument that the 1936 order is conclusive *because it says so* (Reply, pp. 4, 7) begs the question, since constitutional rights cannot be shut off merely by an *assertion*, in the absence of a justiciable controversy.

Other arguments in the Reply are also plainly erroneous, viz.:

1. The New Company argues that it was open to Appellants in 1936 to assert the invalidity of the advance consent of the Conservator, as being a deprivation of their constitutional rights (Reply, p. 7); and for that proposition they cite a portion of the opinion below (Reply, p. 7, fn. **). But that argument begs the question, because a person cannot assert in the abstract that something deprives him of constitutionl rights, but must show *that* he has been deprived—and *how* he has been deprived—of life, liberty or property without due process. See Br. Opp. No. 584, p. 10, fn. **. Moreover, this is particularly so where there could be no way of knowing what the applicable law might be at the time when the request for mutualization might be made. See Br. Opp. No. 584, p. 9, fn. See also App. F-24.

2. New Company profusely cites and quotes from *Neblett* v. *Carpenter*, 305 U. S. 297, in a manner which gives the misleading impression that this Court decided in that case the issues which are being raised in the instant proceeding (Reply, pp. 3-4, 7). But the fact is

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that the Old Company stockholders were not parties to any of the appeals which culminated in this Court's decision in *Neblett* v. *Carpenter, supra*, and any reading of that opinion makes it clear that this Court did not at that time have any of the present issues before it, but was addressing itself to entirely different questions.

3. The New Company's argument with respect to the separability clause in the Rehabilitation Agreement (Reply, p. 6) ignores the fact that the separability clause relates only to the mutualization provisions of the Rehabilitation Agreement. The existence of such a reservation in the context in which it appears leads to a conclusion precisely contrary to that urged by the New Company. The inclusion of the separability clause in the mutualization provisions establishes that the issues to which it applies remain open for future litigation. Therefore, any finding as to the validity of the advance consent was not necessary to sustain the 1936 order of the Superior Court. No citation of cases is required for the established proposition that findings which are not necessary to sustain a judgment, or to reach a decision, are not *res judicata* in any future litigation.

The superficiality of New Company's position on *res judicata* clearly appears in the final sentences of its Reply (p. 8):

> ". . . Policyholders, in accepting reinsurance twenty years ago and in purchasing new insurance since that time, have relied on the fact that the Superior Court's order meant what it said in barring all future attacks on any provisions of the Rehabilitation Agreement, including the mutualization option which gave them an opportunity to become

owners of the Company. In the 1936 litigation, appellants might have challenged the provisions of the Rehabilitation Agreement binding the Conservator (and, through him, appellants) to consent to the price and terms of payment fixed by the plan of mutualization promulgated in accordance with the terms of the Agreement. They did not elect to make the challenge then; they may not do so now."

We are not arguing that policyholders, who accepted reinsurance in, or purchased new insurance from, New Company are not entitled to exercise the option to mutualize. But it does not follow from this that these policyholders, in the exercise of this option, are entitled to have the State of California take Appellants' property at a confiscatory price for their benefit. We are not attacking "the mutualization option" in the Rehabilitation Agreement. We are attacking the Plan of Mutualization and we are attacking the procedures by which this plan, though confiscatory, has been held to be fair and equitable, without a procedurally fair administrative or judicial hearing. We are claiming that we are not foreclosed from demanding a fair and equitable plan, and procedurally sufficient hearing and judicial review, by anything that was approved by the Superior Court in 1936.

Respectfully submitted,

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March 8, 1956.

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